Supreme Court, U. S.
FILED
OCT 28 1975

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 75-633

TOUCHE ROSS & CO.,

Petitioner,

vs.

ROBERT SEIFFER, ET AL.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

FRANCIS J. HIGGINS,
135 South LaSalle Street,
Chicago, Illinois 60603,

GEORGE M. WINGER,
1411 Commerce Bank Building,
Kansas City, Missouri 64106,
Attorneys for Petitioner, Touche Ross & Co.

Of Counsel:
BELL, BOYD, LLOYD, HADDAD & BURNS,
Chicago, Illinois,
SMITH, SCHWEGLER, SWARTZMAN & WINGER, INCORPORATED,
Kansas City, Missouri.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

TABLE OF CONTENTS.

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Constitutional Provisions, Statutes, and Rules Involved	2
Statement of the Case	2
Reasons for Granting the Writ	5
A. This Lawsuit Cannot Be Maintained as a Class Action Against Petitioner Because the Individual Issues Regarding Each Plaintiff's Due Diligence in Bringing Suit Against Petitioner Predominate Over Any Common Issues	6
B. The District Court's Objective Standard of Due Diligence Is Contrary to Substantive Law and Contravenes Both the Rules Enabling Act and the Petitioner's Fifth and Seventh Amendment Rights Under the Constitution of the United States	7
C. The District Court's Class Action Certification Was, as to Petitioner, a Final Determination of Right and Is Therefore Appealable Under 28 U. S. C. § 1291	8
D. The Courts of Appeal Are in Serious Conflict Regarding the Appealability Under 28 U. S. C. § 1291 of Orders Certifying Class Actions	10
E. This Case Should Be Reviewed by This Court Because the Decisions of the District Court and the Tenth Circuit, if Left Standing, Would Abrogate the Limitations Defense in Class Actions Without Affording the Class Action Defendant Any Practical Means of Appellate Review	11
Conclusion	12

Appendix:

A—District Court Opinion A1
B—District Court Judgment A9
C—Court of Appeals Order of September 19, 1974.. A11
D—Court of Appeals Order of January 8, 1975 .... A12
E—Court of Appeals Opinion A14
F—Court of Appeals Order of August 26, 1975 ... A20
G—United States Constitution, Fifth Amendment .. A21
H—United States Constitution, Seventh Amendment A22
I—28 U. S. C. Section 1291 ..... A22
J—Rules Enabling Act, 28 U. S. C. Section 2072 .. A23
K—Federal Rules of Civil Procedure, Rule 23 ..... A24
L—Opinion of the Court of Appeals for the Ninth Circuit in *Blackie* v. *Barrack* (September 25, 1975) A27

TABLE OF AUTHORITIES.

Cases.

Affiliated Ute Citizens v. United States, 406 U. S. 128 (1972) 7

Bailey v. Glover, 88 U. S. 342 (1874) 6

Blackie v. Barrack, CCH Fed. Sec. L. Rep. ¶ 95,312 (9th Cir. September 25, 1975) 11

Blue Chip Stamps v. Manor Drug Stores, ... U. S. ....., 95 S. Ct. 1917 (1975) 11

Campbell v. Haverhill, 155 U. S. 610 (1895) 8

Cohen v. Beneficial Industrial Loan Corp., 337 U. S. 541 (1949) 8, 10

de Haas v. Empire Petroleum Company, 435 F. 2d 1223 (10th Cir. 1970) 6, 7

Eisen v. Carlisle & Jacquelin, 370 F. 2d 119 (2d Cir. 1966), *cert. denied*, 386 U. S. 1035 (1967)..... 10

Eisen v. Carlisle & Jacquelin, 479 F. 2d 1005 (2d Cir. 1973), *vacated*, 417 U. S. 156 (1974) 10

Eisen v. Carlisle & Jacquelin, 417 U. S. 156 (1974) 8, 9, 10, 11

Falk v. Dempsey-Tegeler & Co., Inc., 472 F. 2d 142 (9th Cir. 1972) 10

Gillespie v. United States Steel Corporation, 379 U. S. 148 (1964) 9

Hackett v. General Host Corporation, 455 F. 2d 618 (3rd Cir. 1972), *cert. denied*, 407 U. S. 925 (1972) 10

Herbst v. International Telephone and Telegraph Corporation, 495 F. 2d 1308 (2d Cir. 1974) 10, 11

Holmberg v. Armbrecht, 327 U. S. 392 (1946) 6

King v. Kansas City Southern Industries, Inc., 479 F. 2d 1259 (7th Cir. 1973) 10

Monarch Asphalt Sales Co., Inc. v. Wilshire Oil Company of Texas, 511 F. 2d 1073 (10th Cir. 1975) 10

Williams v. Mumford, 511 F. 2d 363 (D. C. Cir. 1975) .. 10

Constitutional Provisions.

United States Constitution, Fifth Amendment 2, 7, 8

United States Constitution, Seventh Amendment 2, 7, 8

Statutes.

28 U. S. C. § 1254(1) 2

28 U. S. C. § 1291 .....2, 5, 6, 8, 9, 10

28 U. S. C. § 1292(b) 5

Rules Enabling Act, 28 U. S. C. § 2072 ..... 2, 7, 8

Kansas Statutes Annotated, § 60-513(3) 4

Securities Act of 1933, Section 17(a) (15 U. S. C. § 77q(a)) 2

Securities Exchange Act of 1934, Section 10(b) (15 U. S. C. § 78j(b)) 3

Rules.

Securities Exchange Commission, Rule 10b-5 (17 C. F. R. § 240.10b-5) 3

Federal Rules of Civil Procedure, Rule 23 .....2, 5, 7, 8, 9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No.

TOUCHE ROSS & CO.,

Petitioner,

vs.

ROBERT SEIFFER, ET AL.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

Touche Ross & Co. hereby petitions this Court to issue a writ of certiorari to review the judgment and the opinion of the United States Court of Appeals for the Tenth Circuit entered in this case on July 28, 1975.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Tenth Circuit is not yet officially or unofficially reported; a copy of the opinion is printed in the Appendix to this petition at page A14. The opinion of the United States District Court for the District of Kansas is officially reported at 64 F. R. D. 714; a copy of that opinion is printed in the Appendix at page A1.

JURISDICTION.

The order of the Tenth Circuit dismissing Touche Ross' appeal was entered on July 28, 1975. Touche Ross' petition for rehearing *en banc* was denied by the Tenth Circuit in an order entered on August 26, 1975. (A20) This Court has jurisdiction to review the decision of the Court of Appeals pursuant to 28 U. S. C. § 1254(1).

QUESTION PRESENTED.

Whether the District Court's order certifying this suit as a class action is, as to petitioner, a final determination of right immediately appealable under 28 U. S. C. § 1291 because the District Court, in an attempt to accommodate the suit to the procedural requirements of Fed. R. Civ. P. 23, modified substantive law regarding proof of diligence under the federal tolling doctrine, in violation of both the Rules Enabling Act, 28 U. S. C. § 2072, and petitioner's Fifth and Seventh Amendment rights.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED.

The constitutional provisions, statutes, and rules involved herein are the Fifth and Seventh Amendments to the United States Constitution, 28 U. S. C. § 1291, the Rules Enabling Act (28 U. S. C. § 2072), and Rule 23 of the Federal Rules of Civil Procedure. The text of each provision is set forth in the Appendix at pages A21-A26.

STATEMENT OF THE CASE.

The respondents are nine purchasers of the securities of Topsy's International, Inc., who allege that Topsy's and others violated Section 17(a) of the Securities Act of 1933 [15

U. S. C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 [15 U. S. C. § 78j(b)], and Rule 10b-5 of the Securities Exchange Commission [17 CFR § 240.10b-5] in connection with the sale of Topsy's securities. The appeal herein was from a judgment of the District Court that Count I of the complaint, which alleged violations of the federal securities laws, could proceed as a class action on behalf of all purchasers of Topsy's common stock from September 28, 1968 to March 10, 1970 or of Topsy's debentures from February 4, 1969 to March 10, 1970. (A9)

Respondents' initial complaint, filed on November 11, 1971, named Topsy's and its principal officers, Jerry Berger, James T. House, and Harry Nuell, as defendants. Topsy's is a Delaware corporation with its principal offices in Kansas City, Missouri, and is engaged in the sale of snack foods from wholly-owned and franchised facilities in department stores and shopping centers.

Petitioner Touche Ross & Co. is a firm of independent certified public accountants which performed audit examinations of the financial statements prepared by Topsy's for Topsy's and its consolidated subsidiaries for the fiscal years ending in 1968 and 1969, and issued accountant's reports regarding the results of each audit examination. Petitioner was not named as a defendant until October 17, 1973, when respondents filed a Third Amended Complaint which merely alleged that petitioner "knew or had reason to know" that "certain" documents or articles published in 1968 or 1969 regarding Topsy's contained false or misleading statements.

Petitioner's Accountant's Report regarding the Topsy's financial statements as of July 31, 1968 was dated October 23, 1968; this report was included in Topsy's 1968 Annual Report to Shareholders, dated October 31, 1968, in a Registration Statement filed by Topsy's with the Securities Exchange Commission on October 29, 1968, and in a Prospectus which became effective on February 4, 1969.

As a result of its audit examination of the financial statements prepared by Topsy's for Topsy's and its consolidated subsidiaries as of August 2, 1969, petitioner issued a second Accountant's Report, dated November 14, 1969, which was included in Topsy's 1969 Annual Report to Shareholders, dated November 25, 1969. The latest purchase of Topsy's securities by any of the respondents was on August 1, 1969, prior to the publication of the 1969 Annual Report.

Respondents' allegations regarding false or misleading statements essentially relate to SaxonS Sandwich Shoppes, Inc., a company engaged in the operation and franchising of roast beef sandwich shops which was acquired by Topsy's on August 1, 1968. This acquisition was disclosed as a "subsequent event" in the 1968 financial statements of Topsy's.

The SaxonS venture was unsuccessful. Topsy's informed its shareholders in March 1970 that it was repurchasing SaxonS franchises and in June 1970 that it was discontinuing the SaxonS operations and recognizing an extraordinary loss. The class was certified to include purchasers of Topsy's stock or debentures through March 10, 1970.

Although the applicable limitations period under Kansas law is two years [KSA 60-513(3)], petitioner was not named a defendant until October 17, 1973, which was almost five years after publication of the 1968 Topsy's Annual Report to Shareholders (October 31, 1968) and the filing of Topsy's registration statement (October 29, 1968); over four years after the last purchase of Topsy's securities by one of the respondents (August 1, 1969); over three years after the public announcement by Topsy's that its SaxonS subsidiary had discontinued operations (June 24, 1970); and almost two years after respondents filed their initial complaint (November 11, 1971).

In the judgment decreeing the suit a class action, the District Court certified that its order involved "controlling questions of law as to which there is substantial ground for difference of

opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation." (A10) Petitioner therefore filed with the Court of Appeals a petition for leave to appeal, pursuant to 28 U. S. C. § 1292(b), from the class action judgment. In an order dated September 19, 1974, the Court of Appeals denied the petition for leave to appeal. (A11)

On August 22, 1974, petitioner filed a notice of appeal, pursuant to 28 U. S. C. § 1291, of the judgment decreeing the action maintainable as a class action. Respondents moved to dismiss the appeal on the ground that the Court lacked jurisdiction. The Court of Appeals, in an order dated January 8, 1975, denied the motion to dismiss (A12) but then, on July 28, 1975, dismissed the appeal for lack of jurisdiction. Petition for rehearing *en banc* was denied on August 26, 1975. (A20)

On or about October 3, 1975, respondents and defendants Topsy's, Berger, House, and Nuell filed with the District Court a proposed settlement agreement and a joint motion for notice to the alleged class. Touche Ross & Co. is *not* a party to that proposed settlement and intends to prosecute this Petition even if the corresponding Petition for Certiorari of Topsy's, et al., should be withdrawn because of their separate settlement.

REASONS FOR GRANTING THE WRIT.

This case presents issues of special, immediate, and unique importance to the federal judicial system and therefore merits review by this Court. The decision of the District Court certifying this suit as a class action, which the Tenth Circuit declined to review on appeal, raises an important question regarding the subordination of substantive law to the supposed exigencies of permitting class actions in the federal judicial system. The District Court, in order to accommodate the case to the requirement of Rule 23 that class actions present common questions of law and fact, altered the substantive federal law regarding proof of

diligence in complying with the applicable statute of limitations. The Tenth Circuit's dismissal of petitioner's appeal under 28 U. S. C. § 1291 is a product of serious conflict among the federal courts of appeals on questions left open by this Court concerning the appealability of class action certifications. This Court should grant the petition and review the class certification in order to resolve the conflict among the circuits regarding appealability of class actions and to prevent the District Court's order from causing irreparable harm to petitioner and others similarly situated.

A. This Lawsuit Cannot Be Maintained as a Class Action Against Petitioner Because the Individual Issues Regarding Each Plaintiff's Due Diligence in Bringing Suit Against Petitioner Predominate Over Any Common Issues.

Because no member of the class initiated suit against petitioner within two years after purchasing his securities, as required by the two-year Kansas statute of limitations for fraud, each member of the class must establish that the statute of limitations was tolled as to him. Under the equitable tolling doctrine developed by the federal courts, the limitations period begins to run when the claimant in the exercise of due diligence should have discovered the alleged fraud. *Bailey* v. *Glover*, 88 U. S. 342, 347 (1874); *Holmberg* v. *Armbrecht*, 327 U. S. 392, 397 (1946); *de Haas* v. *Empire Petroleum Company*, 435 F.2d 1223, 1226 (10th Cir. 1970).

The District Court recognized that if the trier of fact were required to determine that every member of the class—estimated at 4700 persons—had exercised due diligence, individual questions would predominate over common questions and the suit could not proceed as a class action. The District Court resolved this difficulty by holding that an "objective standard" of due diligence was applicable and that the trier of fact need only determine whether a reasonable investor would have acted differently. 64 F. R. D. at 719. (A6)

In so holding, the District Court misapplied this Court's decision in *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972),[1] and ignored the subjective standard of due diligence formulated by the Tenth Circuit itself in *de Haas* v. *Empire Petroleum Company*, 435 F. 2d 1223, 1226 (10th Cir. 1970).

B. The District Court's Objective Standard of Due Diligence Is Contrary to Substantive Law and Contravenes Both the Rules Enabling Act and the Petitioner's Fifth and Seventh Amendment Rights Under the Constitution of the United States.

The District Court, when confronted with the tension between the requirement of the federal common law that every plaintiff prove his diligence in discovering fraud and the requirement of Rule 23(b)(3) that common questions in a class action predominate over individual ones, changed the law to accommodate the suit to Rule 23. 64 F. R. D. at 719. (A6)

This holding is in direct contravention of the Rules Enabling Act, 28 U. S. C. § 2072, which, in granting this Court authority to promulgate the Federal Rules of Civil Procedure, expressly provides that such rules shall not abridge or modify a substantive right and shall preserve the right to trial by jury provided by the Seventh Amendment. Rule 23 is thus merely a procedural device and does not allow a federal court to modify the substantive law to make a class action viable.

If an individual plaintiff had sued petitioner, the individual could be deposed and later cross-examined at trial and his testimony would be subject to impeachment and rebuttal. The trier of fact could then, on the basis of demeanor and all other traditional factors, assess the credibility of the individual's

1. *Affiliated Ute* dealt with the standard to be used in determining the element of reliance in a securities fraud action (406 U. S. at 153-4); it did not involve a limitations problem or the question of an investor's due diligence in initiating suit.

claim of due diligence. To hold, as the District Court did, that this individual assessment of due diligence does not apply where it will defeat the viability of the suit as a class action is to disregard openly the limitations of the Rules Enabling Act to the detriment of petitioner's right to cross-examination under the due process clause of the Fifth Amendment and its right to a jury trial under the Seventh Amendment.

The mandate of Rule 23 does not empower the District Court to create a privileged class of plaintiffs who can collectively recover against petitioner in circumstances where their claims would have been barred by the statute of limitations if they had sued individually. See *Campbell* v. *Haverhill*, 155 U. S. 610, 616 (1895). Yet the District Court, in order to permit a case with pervasive limitations problems to proceed as a class action, adopted a double standard of diligence, thereby creating a privileged class of claims subject to no effective limitations period.

The ruling of the District Court, if unreviewed, will compel the conclusion that the statute of limitations is virtually meaningless in any alleged class action under the federal securities laws. Moreover, the decision of the Court of Appeals, if allowed to stand, will effectively deny this petitioner and other similarly situated class action defendants any appeal of a class certification.

C. The District Court's Class Action Certification Was, as to Petitioner, a Final Determination of Right and Is Therefore Appealable Under 28 U. S. C. § 1291.

The test of appealability outlined by this Court in *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541 (1949) and *Eisen* v. *Carlisle & Jacquelin*, 417 U. S. 156 (1974) (*Eisen III*), if properly applied to this case, would require appellate review of the District Court's decision that this suit should proceed as a class action as to petitioner. In *Eisen*, this Court reaffirmed the conclusions reached in *Cohen*, 337 U. S. at 546, that the requirement of finality in 28 U. S. C. § 1291 should be given a

"practical rather than a technical construction" and that there exists a small class of orders which, although not finally terminating an action, are final determinations of right, are collateral to the merits of the action, and are too important to be denied appellate review until after termination of the litigation. 417 U. S. at 171-172. See also *Gillespie* v. *United States Steel Corp.*, 379 U. S. 148, 152 (1964).

This appeal satisfies the requirements set by this Court for finality under § 1291: the District Court's decision that an objective standard of diligence was applicable in determining when the limitations period began to run, with the result that no member of the class need prove his diligence, was a conclusive determination on a question of right collateral to respondents' substantive claims of fraud. *Eisen III*, 417 U. S. at 171. That holding of the District Court, unlike the procedural elements of the class action certification, which are subject to modification under Fed. R. Civ. P. 23(c)(1), is a final determination of a substantive right and is now the law of the case.

The District Court's decision is fundamental to the further conduct of this suit and causes irreparable harm to petitioner because it is unlikely that this action could proceed against petitioner except as a class action, given the limitations hurdle each claimant would face in individual actions and the failure of any of the respondents, when deposed, to identify any substantive claim against petitioner. The Court's order, moreover, deprives petitioner of its constitutional rights to examine at trial each class member regarding his diligence in raising his claim against petitioner within the limitations period. The District Court's modification of substantive law is so egregious and the consequent harm to petitioner so serious that appellate review cannot be further delayed.

The District Court's order is in this respect similar to the allocation of notice costs in *Eisen III*, which might have been subsequently modified by the District Court or appealed after a

trial on the merits, but only after irreparable harm had been done to the defendants.

D. The Courts of Appeals Are in Serious Conflict Regarding the Appealability Under 28 U. S. C. § 1291 of Orders Certifying Class Actions.

Despite this Court's decisions in *Eisen III* and *Cohen*, the Courts of Appeals have rendered confusing and conflicting decisions regarding the circumstances under which orders allowing suits to proceed as class actions would be considered final decisions appealable under 28 U. S. C. § 1291.

Several federal courts of appeals permit appeal of an order *denying* a class certification under circumstances in which the order sounds the "death knell" for the suit. *Eisen* v. *Carlisle & Jacquelin*, 370 F. 2d 119 (2d Cir. 1966), *cert. denied*, 386 U. S. 1035 (1967) *(Eisen I)*; *Falk* v. *Dempsey-Tegeler & Co., Inc.*, 472 F. 2d 142 (9th Cir. 1972); *Williams* v. *Mumford*, 511 F. 2d 363 (D. C. Cir. 1975); *Monarch Asphalt Sales Co., Inc.* v. *Wilshire Oil Company of Texas*, 511 F. 2d 1073 (10th Cir. 1975); *contra, King* v. *Kansas City Southern Industries, Inc.*, 479 F. 2d 1259 (7th Cir. 1973); *Hackett* v. *General Host Corporation*, 455 F. 2d 618 (3rd Cir. 1972), *cert. denied*, 407 U. S. 925 (1972).

Significant disagreement nonetheless persists among the circuits as to the appealability of decisions *granting* certification of a class. The Court of Appeals for the Second Circuit has construed *Cohen* as allowing appeal under § 1291 when an order granting class action status is fundamental to the further conduct of the case, is separable from the merits, and will result in irreparable harm to the defendant. *Herbst* v. *International Telephone and Telegraph Corp.*, 495 F. 2d 1308, 1312 (2d Cir. 1974); *Eisen* v. *Carlisle & Jacquelin*, 479 F. 2d 1005, 1007 n. 1 (2d Cir. 1973) (*Eisen III*). However, the Court of Appeals for the Ninth Circuit in a very recent decision explicitly rejected

the approach of the Second Circuit and refused to allow appeal of any decision certifying a class. *Blackie* v. *Barrack*, CCH Fed. Sec. L. Rep. ¶ 95,312 (9th Cir. September 25, 1975) (the Court's opinion is printed in the Appendix at A27).

In the present action, the Court of Appeals for the Tenth Circuit, while properly adopting the "three-pronged" test developed by the Second Circuit, applied that approach in such a manner as to effectively limit appeal of class action certifications to the specific facts in *Eisen III*, even though this Court did not decide in that case the appealability of other issues raised by the class certification. 417 U. S. at 172, n. 10. The Tenth Circuit distinguished this appeal from the appeals granted in *Eisen* and *Herbst* in technical rather than practical ways, effectively precluding satisfactory relief from the District Court's error, not only for this petitioner but also for thousands of actual or potential litigants in that circuit.

E. This Case Should Be Reviewed by This Court Because the Decisions of the District Court and the Tenth Circuit, If Left Standing, Would Abrogate the Limitations Defense in Class Actions Without Affording the Class Action Defendant Any Practical Means of Appellate Review.

The District Court's abrogation of the requirement that every claimant prove his diligence in complying with the statute of limitations, compounded by the Court of Appeals' refusal to review the question until after trial on the merits, can only encourage the bringing of groundless and stale claims as class actions, while heightening the pressure upon defendants to dispose of such suits without any resolution on the merits. See *Blue Chip Stamps* v. *Manor Drug Stores*, ... U. S. ....., 95 S. Ct. 1917, 1927-1929 (1975).

The differences among the circuits are irreconcilable, are causing confusion and disparate treatment, and are leading to a discriminatory system of justice demanding definitive resolu-

tion. It is essential that this Court accept this appeal, resolve the conflict among the circuits, and reverse the District Court's abrogation of substantive rights.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this Court should grant the Petition for a Writ of Certiorari to review the decision of the Court of Appeals for the Tenth Circuit.

Respectfully submitted,

FRANCIS J. HIGGINS,
135 South LaSalle Street,
Chicago, Illinois 60603,

GEORGE M. WINGER,
1411 Commerce Bank Building,
Kansas City, Missouri 64106,
Attorneys for Petitioner,
Touche Ross & Co.

Of Counsel:
BELL, BOYD, LLOYD,
HADDAD & BURNS,
Chicago, Illinois,

SMITH, SCHWEGLER,
SWARTZMAN & WINGER,
INCORPORATED,
Kansas City, Missouri.

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
For the District of Kansas

ROBERT SEIFFER, et al.,
Plaintiffs,
vs.
TOPSY'S INTERNATIONAL, INC., et al.,
Defendants.

Civil Action
No. KC-3435

MEMORANDUM AND ORDER

Plaintiffs filed their original complaint alleging certain securities act violations, both federal and state, on November 11, 1971. Since that time, plaintiffs have filed several amended complaints, additional parties defendant have been added, cross-claims and third-party complaints have been filed, and extensive discovery has been conducted. All of this is by way of prefacing the issue we reach here: whether or not the plaintiffs should be allowed to maintain this action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure.

The court has already denied a motion for an order declaring this action not a class action. (Memorandum and Order of October 2, 1972, p. 8.) Our ruling was conditioned upon (1) a showing that plaintiffs' discovery of the alleged fraud is consistent with the requisite diligence; and (2) assuming such a showing is made, that plaintiffs amend their complaint to define clearly and with particularity the class of plaintiffs they seek to represent. We believe that the amendments to plaintiffs' complaint have satisfied the second condition; hence, we now turn to consider the due diligence issue.

Plaintiffs essentially allege that defendants participated in a scheme to defraud the class they seek to represent in violation of § 17(a) of the Securities Act of 1933 [15 U. S. C. § 77q(a)] and of § 10(b) of the Securities Exchange Act of 1934 [15 U. S. C. § 78j(b)] and Rule 10b-5 promulgated thereunder (17 C. F. R. § 240.10b-5). We have already determined that the statute of limitations in this private suit for damages under Rule 10b-5 is the Kansas statute of limitations for fraud, K. S. A. 60-513(3), which provides for a two-year period from the date of discovery of the fraud. (Memorandum and Order of October 2, 1972, p. 7.) But the federal tolling doctrine applies in the determination of when plaintiffs, in the exercise of due diligence should have discovered the alleged fraud. *Esplin* v. *Hirschi*, 402 F. 2d 94 (10th Cir. 1968); *deHaas* v. *Empire Petroleum Company*, 435 F. 2d 1223 (10th Cir. 1970). It requires no restatement of the alleged facts of this case and of the relationship of the parties for this court to determine that this is an issue for the trier of fact. Seldom is it possible for such an issue to be determined summarily. *Dzenitz* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 494 F. 2d 168 (10th Cir. 1974). The court is therefore satisfied that the conditions previously imposed have been met insofar as is possible at this time. Our ruling in this regard is applicable to defendant Touche, Ross & Company even though it was not joined as a defendant until October 17, 1973, when plaintiffs' third amended complaint was filed.

In addition to the conditions imposed by the court, Rule 23 establishes several prerequisites for the maintenance of a class action. Firstly, the alleged class of defrauded purchasers must be so numerous that joinder of all members is impracticable. Here the number of persons who purchased Topsy's securities, both common stock and debentures, in the February 4, 1969, offering alone, while difficult to determine with any degree of certainty, may well exceed 1,000. Thus the court believes that this first prerequisite has been satisfied.

Secondly, there must be questions of law or fact common to the class. Inasmuch as the alleged scheme to defraud was designed to inflate the price of Topsy's securities, all of the class members who purchased those securities during the relevant period of time would presumably have been affected, albeit in varying degrees. We will consider later in this memorandum whether the common issues relating to the alleged fraud predominate over individual ones. For now, we conclude that there are common questions of law and fact.

Thirdly, the claims or defenses of the representative parties must be typical of the claims or defenses of the class. This requirement appears to duplicate other provisions of the rule, *i.e.*, the common questions and representative party provisions. 3B Moore's Federal Practice ¶ 23.06-2. In view of our rulings on these other provisions, we hold that the claims of the plaintiffs are typical of those of the class of purchasers who have allegedly been defrauded by defendants' scheme.

Finally, the representative parties must fairly and adequately protect the interests of the class. Plaintiffs seek to represent a class of purchasers of the common stock of defendant Topsy's International from September 28, 1968, to March 10, 1970, and purchasers of the debentures of Topsy's from February 4, 1969 (when they were first offered), to March 10, 1970. These dates roughly coincide with when Topsy's shareholders would have received letters from the company's management announcing the acquisition of SaxonS Sandwich Shoppes, Inc., in September 1968, and announcing the losses from the repurchase of SaxonS units in March 1970. It was during this period of time that defendants are alleged to have maintained an inflated price for Topsy's securities through a fraudulent scheme whereby defendants' public statements painted an overly optimistic picture of the SaxonS operation, when in truth there was no reasonable basis for making such statements. Since the named plaintiffs purchased stock and debentures during this period, we see no reason why they cannot fairly and adequately protect the interests

of all those who purchased in that span of time. Even though defendants contend these plaintiffs' purchases were not exactly coextensive with the proposed class, we are of the opinion that there is no inconsistency with the interests of other members of the class who purchased at other times during the relevant period which would prevent the named plaintiffs from representing the whole class. Defendants also specifically challenge the willingness and ability of certain of the named plaintiffs to represent the class, and, further, the ability of the plaintiffs' attorneys to represent the class because of an alleged conflict of interest with a third party defendant. We do not believe these matters of sufficient import to deny certification of the class. We hold that plaintiffs have met all the prerequisites of Rule 23(a).

In addition to the prerequisites of subdivision (a) of Rule 23, plaintiffs must satisfy one of the sections of subdivision (b). Plaintiffs contend that this action falls within (b)(3):

> "the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

Defendants voice strenuous objections to certification of a (b)(3) type class. Because the list of matters pertinent to the court's findings under (b)(3) is non-exhaustive (Notes of the Advisory Committee Regarding the 1966 Amendment to Rule 23), defendants raise issues which, for the most part, are unique to this kind of 10b-5 action.

Defendants first contend that reliance is a necessary element in a 10b-5 action and that this issue is primarily an individual

one, citing in particular *Financial Industrial Fund, Inc.* v. *McDonnell Douglas Corp.*, 474 F. 2d 514 (10th Cir. 1973). The element of reliance in 10b-5 cases is usually considered part of the larger issue of causation. Thus, in a case very similar to this, the United States Supreme Court held:

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. (*Citations omitted.*) This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. (*Citation omitted.*)" *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 153-54, 31 L. Ed. 2d 741, 92 S. C. 1456 (1972).

We regard the *Affiliated Ute* case as controlling here. See *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402 (3rd Cir. 1974); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 42 L. W. 2544, April 23, 1974 (2nd Cir.); *Dorfman* v. *First Boston Corp.*, 42 L. W. 2552, April 30, 1974 (E. D. Pa.); *Werfel* v. *Kramarsky*, 61 F. R. D. 674 (S. D. N. Y. 1974). Defendants err in thinking that the Tenth Circuit in the *Financial Industrial Fund* case implied any different standard than that set forth in *Affiliated Ute*, where the Supreme Court overruled the Tenth Circuit's restrictive interpretation of the reliance issue in a 10b-5 case. We therefore conclude that reliance is not a bar to plaintiffs' maintenance of a class action.

Defendants next contend that there are material differences in the alleged misrepresentations which preclude class action treatment of this suit. On the other hand, it has been suggested that a fraud perpetrated on numerous persons by the use of similar misrepresentations is an appealing situation for a class action. (Notes of the Advisory Committee Regarding the 1966 Amendment to Rule 23.) Despite the fact that the alleged misrepresentations regarding the SaxonS operation appeared in different

publications at different times, they all emanated from the defendants as part of the alleged fraudulent scheme to maintain an inflated price for Topsy's securities, and in the opinion of the court they are interrelated and cumulative. Moreover, plaintiffs are primarily alleging a complete failure to disclose material facts—which default was necessarily common to all members of the proposed class. *Esplin* v. *Hirschi, supra.* Thus we believe the common issues predominate over individual ones insofar as the alleged misrepresentations and omissions are concerned. Parenthetically, we would observe that cases, which the defendants have cited such as *Simon* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973), are inapposite because they involve oral misrepresentations.

Defendants further contend that the limitations issue makes this case unsuitable for class action designation. The court has previously expressed some misgivings about the propriety of maintaining a class action because of this very issue. Though plaintiffs have convinced the court that their due diligence in discovering the alleged fraud is an issue for the trier of fact (*supra*, p. 2), we must now inquire whether there must be an individual determination of the due diligence issue which would predominate over questions common to the class. If each of the members of the prospective class were required to prove his or her due diligence in discovering the alleged fraud, the individual questions would indeed predominate over the common ones. But we believe a more objective standard could and should be applied; otherwise a class action would never be feasible in a case such as this. The standard should be whether a reasonable investor, in light of the facts existing at the time of the nondisclosure and in the exercise of due care, would have been entitled to receive full disclosure from the party charged and would have acted differently had the alleged nondisclosure not occurred. *City National Bank of Fort Smith, Ark.* v. *Vanderboom*, 422 F. 2d 221 (8th Cir. 1970). Thus the due diligence issue, which in a case such as this is really an extension of the

issue of causation in fact, can be determined by resorting to the same "reasonable investor" test employed by the Supreme Court in the *Affiliated Ute* case, *supra*. It is only by using such an approach that the court is freed from the overwhelming task of examining the subjective intent of each class member. *Grad* v. *Memorex Corporation*, CCH Fed. Sec. L. Rep. ¶ 94,029 (N. D. Cal. 1973). We conclude that plaintiffs have satisfied the requirement that the common issues predominate over individual ones.

Finally, we must decide whether a class action is superior to other available methods for the fair and efficient adjudication of the controversy. It has been our view that the class action appears particularly suitable for this kind of shareholder suit. (Memorandum and Order of October 2, 1972, p. 8.) While we are well aware of the potential burden upon the court and jury posed by the maintenance of a class action, our primary task is to see that the securities laws are enforced to protect investors from fraud of whatever magnitude as intended by Congress. *Securities and Exchange Commission* v. *International Chemical Development Corp.*, 469 F. 2d 20 (10th Cir. 1972). Furthermore, it has been said that "the ultimate effectiveness of [the security anti-fraud laws] may depend on the applicability of the class action device." Loss, Securities Regulation, 2d Ed. 1961, p. 1819. Following Judge Hill's directive in *Esplin* v. *Hirschi*, *supra*, that if there is to be any error it should be committed in favor of allowing the class action, we hold that the class action is superior to other available methods for the fair and efficient adjudication of this controversy.

The plaintiffs' motion to strike defendants' supplemental brief has been rendered moot by the court's order herein. The issue of the possible liability of defendant Touche, Ross is not, in our view, properly raised in connection with the class action issue and will not be treated here.

CONCLUSION

The court finds that the requirements of Rule 23 have been met and that this action should proceed as a class action. The court hereby certifies a class of purchasers who bought Topsy's common stock from September 28, 1968, to March 10, 1970, and who bought Topsy's debentures from February 4, 1969, to March 10, 1970, and who suffered a loss as a result of the defendants' alleged misrepresentations and omissions. Notice shall be given to the class pursuant to Rule 23(c)(2), with costs to be borne by plaintiffs. *Eisen* v. *Carlisle & Jacquelin*, ... U. S. ——, 42 L. W. 4804 (May 28, 1974). Our ruling applies only to Count I of plaintiffs' third amended complaint; Count II, the Kansas claims which have not been discussed in this memorandum, shall proceed individually. Plaintiffs' counsel are directed to prepare and submit a journal entry of judgment reflecting the conclusion reached here.

IT IS SO ORDERED.

Dated this 27th day of June, 1974, at Kansas City, Kansas.

/s/ EARL E. O'CONNOR
United States District Judge

APPENDIX B

UNITED STATES DISTRICT COURT
District of Kansas

ROBERT SEIFFER, et al.,
Plaintiffs,
vs.
TOPSY'S INTERNATIONAL, INC., et al.,
Defendants.

Civil Action
No. KC 3435

JUDGMENT DECREEING THE ACTION MAINTAINABLE AS A CLASS ACTION

This matter having been fully briefed by the parties including designations of deposition testimony and documents, on plaintiffs' motion for an order declaring the instant action maintainable as a class action pursuant to Rule 23(c)(1) of the Federal Rules of Civil Procedure, with oral argument being held on June 13, 1974; and,

The court having entered a Memorandum and Order on June 27, 1974, determining that all requirements of Rule 23 have been met by plaintiffs and that Count I of plaintiffs' Third Amended Complaint is to be maintained as a class action under Rule 23(b)(3) for and on behalf of plaintiffs and all purchasers of the common stock of Topsys' International, Inc. from September 28, 1968, to March 10, 1970, and all purchasers of Topsy's Convertible Subordinated Debentures due 1984, from February 4, 1969, to March 10, 1970, who suffered a loss as a result of defendants' alleged misrepresentations and omissions, against all of the defendants; it is hereby

ORDERED that Count I of plaintiffs' Third Amended Complaint is to be maintained as a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class comprised of plaintiffs and all other purchasers of (1) Topsy's common stock from September 28, 1968, to March 10, 1970, and (2) Topsy's debentures from February 4, 1969, to March 10, 1970, who suffered a loss as a result of defendants' alleged misrepresentations and omissions.

It is further

ORDERED that notice shall be given to the class members pursuant to Rule 23(c)(2) with costs to be borne by plaintiffs.

It is further

ORDERED that the Memorandum and Order of June 27, 1974 involves controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.

IT IS SO ORDERED.

/s/ EARL E. O'CONNOR
United States District Judge

Date: July 26, 1974

APPENDIX C

UNITED STATES COURT OF APPEALS
Tenth Circuit

September Term—September 19, 1974

Before HONORABLE OLIVER SETH, HONORABLE WILLIAM J. HOLLOWAY, JR., and HONORABLE WILLIAM E. DOYLE, *Circuit Judges*

ROBERT SEIFFER, et al.,
Respondents,
vs.
TOPSY'S INTERNATIONAL, INC., et al.,
Petitioners.
No. 74-8091

TOUCHE ROSS & CO.,
Petitioner,
vs.
ROBERT SEIFFER, et al.,
Respondents.
No. 74-8094

This matter comes on for consideration of petitions for leave to appeal under § 1292(b) of Title 28, U. S. C.

Upon consideration whereof, it is ordered that the petitions for leave to appeal are denied.

/s/ HOWARD K. PHILLIPS
Howard K. Phillips
Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
Tenth Circuit

November Term—January 8, 1975

Before HONORABLE OLIVER SETH, HONORABLE ROBERT H. McWILLIAMS, and HONORABLE JAMES E. BARRETT, *Circuit Judges.*

ROBERT SEIFFER, et al., *Plaintiffs-Appellees,* *vs.* TOPSY'S INTERNATIONAL, INC., JERRY D. BERGER, JAMES T. HOUSE and HARRY NUELL, *Defendants-Appellants,* BEAR, STEARNS & CO., et al., *Defendants.*	Nos. 74-1711 74-1712
ROBERT SEIFFER, et al., *Plaintiffs-Appellees,* *vs.* TOPSY'S INTERNATIONAL, INC., ET AL., *Defendants,* JOHN D. CROUCH, et al., d/b/a TOUCHE ROSS & CO., *Defendants-Appellants,* RALPH J. TUCKER, et al., *Defendants.*	No. 74-1713

This matter comes on for consideration of motions filed in the captioned appeals seeking dismissal of the captioned appeals.

The Court, upon its own motion, had assigned the appeals to Calendar D for consideration pursuant to Rule 8 of the Local Rules of the Tenth Circuit. The parties filed memoranda in support of and in opposition to summary dismissal which were considered by the Court.

Upon consideration whereof, it is the order of the Court as follows:

1. The motions to dismiss summarily are denied in all appeals.

2. The cases are reassigned to Calendar B for briefing and submission to the Court.

3. The cases are companioned and may, if the parties so elect, be briefed as a single appeal.

Despite the provisions of Local Rules 9 and 10 of the Tenth Circuit, the appellants and appellees may prepare a joint appendix in connection with the record on appeal in lieu of reproducing the record in its entirety. The parties are permitted to prepare and file their joint appendix or the reproduced record on or before February 18, 1975. The appellants shall file their brief or briefs on or before March 11, 1975. The appellees may file their brief or briefs on or before April 1, 1975. The appellants shall file their reply brief or briefs, if any, on or before April 16, 1975.

The Court instructs the parties that they should, in addition to other issues on appeal, address in their briefs the question whether the orders sought to be appealed from are final appealable orders within the terms of 28 U. S. C. § 1291.

/s/ HOWARD K. PHILLIPS
Howard K. Phillips
Clerk

APPENDIX E

UNITED STATES COURT OF APPEALS
Tenth Circuit

Nos. 74-1711, 74-1712, 74-1713

ROBERT SEIFFER, et al.,
Plaintiffs-Appellees,
vs.
TOPSY'S INTERNATIONAL, INC., et al.,
Defendants-Appellants.

Appeal from the United States District Court for the District of Kansas (D. C. No. KC-3435)

Before MURRAH, BARRETT and DOYLE, *Circuit Judges.*

MURRAH, *Circuit Judge.*

Topsy's International, Inc., and its accountants Touche Ross & Co. bring this § 1291 appeal from a judgment certifying a class action in a federal[1] securities fraud suit against them and two other defendants not parties to this appeal.[2] The trial court held and all the parties apparently acknowledge that the Kansas two-year statute of limitations is applicable as a defense to the action, unless it can be shown under the federal

1. Only federal claims under 15 U. S. C. §§ 77q(a), 78j(b) and 17 C. F. R. § 240.10b-5 were certified to be maintainable in the class action. The complaint also contained allegations under Kansas state securities laws, which are to proceed individually and are not components of the case being reviewed here.

2. Topsy's underwriters and lawyers are also named as defendants, but they do not join this appeal of the certification of the class.

tolling doctrine[3] that the action was brought within two years of the time when plaintiffs by due diligence would discover or should have discovered the alleged fraud. In holding that the plaintiffs and the defined class meet all the requirements of Fed. R. Civ. P. 23(b)(3), the trial judge concluded that neither the federal securities laws nor the federal tolling doctrine require each class member to prove individual due diligence in discovering the fraud; that, instead, the applicable test is the "objective standard" of whether and when a "reasonable investor" would have discovered the fraud; and that common questions of law and fact thus predominate. Appellants contend that such an objective standard is not the law; that due diligence must be proved individually, making a class action unmanageable; and that we should therefore reverse the order certifying the class. We have previously held that the same order was not appealable under § 1292(b). (Order of September 19, 1974; petition for rehearing en banc denied by Order of October 18, 1974.) We now hold that the order is not appealable under § 1291. This means that, as the record presently stands, the case will be tried as structured by the order certifying the class and that the error in that order, if any, must await review until final decision on the merits.

According to the plaintiffs' allegations, the defendants maintained an artificially inflated price for Topsy's securities by means of misleading annual reports, letters to shareholders, newspaper releases, and purportedly independent research reports, regarding Topsy's financial status and prospects, particularly as to its acquisition of Saxons Sandwich Shoppes, Inc. These reports of Saxons actual and potential profitability were allegedly disseminated, even though Saxons was declining and

3. "[W]here the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered. . . ." Bailey v. Glover, 88 U. S. 342 (1874), quoted in deHaas v. Empire Petroleum Co., 435 F. 2d 1223, 1226 (10th Cir. 1970).

was ultimately closed by Topsy's at a great loss. The trial court's order gave the named plaintiffs the right to represent a class defined as all the damaged purchasers of Topsy's common stock from September 28, 1968, when each shareholder received the same letter from Topsy's favorably announcing its acquisition of Saxons, and all damaged purchasers of Topsy's debentures from February 4, 1969, until March 10, 1970, when the losses from the Saxons operation were revealed in a letter to all shareholders.

Generally, appealability under § 1291 is limited to final judgments reached after trial on the merits. An order allowing or disallowing a class action may be assigned as error at that time. Esplin v. Hirschi, 402 F. 2d 94 (10th Cir. 1968). We have expressed reluctance to grant immediate review of orders granting or denying class status, in view of the fact that such an order is subject to amendment as the trial proceeds. Fed. R. Civ. P. 23(c)(1) and the Notes thereto. In Gerstle v. Continental Airlines, Inc., 466 F. 2d 1374, 1377 (10th Cir. 1972), we held that an order disallowing the class status previously granted was nonappealable under § 1291, since the trial court had expressed its openness to further consideration and modification of the order. See also Gold Strike Stamp Co. v. Christensen, 436 F. 2d 791, 792 n. 2 (10th Cir. 1970). Cf., Wilcox v. Commerce Bank of Kansas City, 474 F. 2d 336 (10th Cir. 1973) (granting § 1292 appealability of an order denying class status).

These cases preceded Eisen v. Carlisle & Jacquelin, 417 U. S. 156, 171 (1973). In that case, the Supreme Court, giving § 1291 "a practical rather than a technical construction," granted appeal from "collateral orders" in a class action before final judgment on the merits. See also Cohen v. Beneficial Industrial Loan Corp., 337 U. S. 541, 546 (1949). In doing so, the Court observed that the determination of finality for purposes of § 1291 may pose a close question and should be guided by balancing "the inconvenience and costs of piece-

meal review on the one hand and the danger of denying justice by delay on the other." It affirmed the Court of Appeals' jurisdiction to review the district court's order allowing a class action with the condition that the defendants bear 90% of the cost of notice to the class. Expressly declining to decide jurisdiction over the issues of manageability and fluid-class recovery, the Court held that the order was appealable because the allocation of notice costs was a "final disposition of a claimed right which is not an ingredient of the cause of action and does not require consideration with it." See generally, Manual for Complex Litigation, pp. 17-51 (1973). In our case, no claim is made as to the propriety of the allocation of notice costs to the plaintiffs. Rather, the ultimate issue sought to be appealed is whether the class action authorized by the order is appropriately manageable.

Following Eisen III, the Courts of Appeals have undertaken to articulate the guidelines governing the § 1291 appealability of a class action order. In denying the appealability of an order granting class standing, in General Motors Corp. v. City of New York, 501 F. 2d 639, 644 (2d Cir. 1974), Chief Judge Kaufman reviewed and reaffirmed the Second Circuit's pre-Eisen three-prong test for § 1291 appealability: (1) whether the class action determination is fundamental to the further conduct of the case; (2) whether review of that order is separable from the merits; and (3) whether that order will cause irreparable harm to the defendant in terms of time and money spent in defending a huge class action. The General Motors case distinguished Herbst v. International Telephone and Telegraph Corp., 495 F. 2d 1308 (2d Cir. 1974), where § 1291 appeal from an order certifying a class action was allowed because the practical viability of the action as well as the defense costs were vastly altered by the order. In that case, the order granting class standing converted the plaintiff from a single individual holding 100 shares to a class of 16,000 shareholders. Cf., Green v. Wolf Corp., 406 F. 2d 291 (2d

Cir. 1968), cert. denied, 395 U. S. 977 (1969) (granting § 1291 appealability of an order denying class status on "death knell" principle).

In Rodgers v. United States Steel Corp., 508 F. 2d 152, 159 (3rd Cir. 1975) (opinion by Judge Gibbons), the court disallowed § 1291 appeal from an order postponing class action determination and restricting communications with potential class members by plaintiffs or their attorneys. In this case, the Third Circuit formulated a similar three-prong appealability test: (1) the order must be a final rather than a provisional disposition of an issue; (2) it must not merely be a step toward final disposition of the merits; and (3) the rights asserted would be irreparably lost if review is postponed until final judgment. See also In re Cessna Aircraft Distributorship Antitrust Litigation, White Industries, Inc. v. The Cessna Aircraft Co., No. 74-1563 (8th Cir. June 23, 1975) (denying § 1291 appealability of an order granting class status); Williams v. Mumford, 511 F. 2d 363 (D. C. Cir. 1975) (denying § 1291 appealability of an order denying class status).

In our case, the "fundamental conduct" or viability of the suit does not turn on the class certification. The inclusion of the estimated 4,700 potential class members will indeed enlarge the stakes in the litigation, but it is not a sine qua non for the further conduct of the suit by the plaintiffs. There is probative evidence on the record that the nine named plaintiffs have substantial personal assets and a total potential recovery of $200,000, and they have manifest an intent to pursue the suit even if denied class status. The order thus does no "irreparable harm" to the defendants. They will be faced with a large and persistent lawsuit whether the class action is allowed or not. Cf. Herbst v. International Telephone and Telegraph, supra, and Eisen III, supra.

Furthermore, the determination of class here is not collateral to the final adjudication of the issues; rather it is an essential

"ingredient of the cause of action" and "require[s] consideration with it." The objective standard for proving plaintiff's due diligence was necessarily established by the order; and proof of due diligence is an integral part of the cause of action whether brought individually or as a class because it involves both the right to bring the suit under the statute of limitations and the ultimate right to recover under the securities laws. See note 1, supra; Affiliated Ute Citizens v. United States, 406 U. S. 128, 153-154 (1972).

Both quantitative and qualitative analysis convince us that it would be improper to review this order until the case has proceeded to a final disposition on the merits. Of course, the order remains subject to reappraisal and modification by the trial court during the course of its proceedings, and nothing herein expressed is intended to hinder or limit that process. We hold that at this juncture review of the order certifying the class is jurisdictionally inappropriate.

The appeal is dismissed.

July 28, 1975.

APPENDIX F

UNITED STATES COURT OF APPEALS
Tenth Circuit

July Term—August 26, 1975

Before THE HONORABLE DAVID T. LEWIS, *Chief Judge*, THE HONORABLE ALFRED P. MURRAH, THE HONORABLE DELMAS C. HILL, THE HONORABLE OLIVER SETH, THE HONORABLE WILLIAM J. HOLLOWAY, JR., THE HONORABLE ROBERT H. MCWILLIAMS, THE HONORABLE JAMES E. BARRETT and THE HONORABLE WILLIAM E. DOYLE, *Circuit Judges*

ROBERT SEIFFER, et al.,
Plaintiffs-Appellees,

vs.

TOPSY'S INTERNATIONAL, INC.,
Defendants-Appellants.

Nos. 74-1711
74-1712
74-1713

This matter comes on for consideration of the apellants' petitions for rehearing, and suggestions for rehearing en banc filed with the Court on August 8, 1975 and August 11, 1975.

Upon consideration whereof, the petitions for rehearing are denied by Circuit Judges Murrah, Barrett and Doyle to whom the cases were argued and submitted.

The petitions for rehearing having been denied by the original panel to whom the cases were argued and submitted and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate procedure, the suggestions for rehearing en banc are denied.

/s/ HOWARD K. PHILLIPS
Howard K. Phillips
Clerk

APPENDIX G

Fifth Amendment to the Constitution of the United States

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb, nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

APPENDIX H

Seventh Amendment to the Constitution of the United States

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

APPENDIX I

28 U. S. C. § 1291

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.

APPENDIX J

Rules Enabling Act, 28 U. S. C. § 2072

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court.

APPENDIX K

Rule 23, Federal Rules of Civil Procedure

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action

is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivisions (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe

those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

APPENDIX L

BLACKIE, ET AL. v. BARRACK, ET AL.; ROBERTS, ET AL. v. KUSHNER, ET AL.; AMPEX CORPORATION v. KUSHNER; TOUCHE ROSS & CO. v. BARRACK, ET AL.

United States Court of Appeals, Ninth Circuit, No.74-2141, No. 74-2341, No. 74-2167, and No. 74-2466. September 25, 1975. Appeal from the United States District Court for the Northern District of California.

Before: TUTTLE,* KOELSCH and BROWNING, *Circuit Judges.*

KOELSCH, Circuit Judge: These are appeals from an order conditionally certifying a class in consolidated actions for violation of Section 10(b) of the Securities and Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C. F. R. § 240.10(b)-5.

The litigation is a product of the financial troubles of Ampex Corporation. The annual report issued May 2, 1970, for fiscal 1970, reported a profit of $12 million. By January 1972, the company was predicting an estimated $40 million loss for fiscal 1972 (ending April 30, 1972). Two months later the company disclosed the loss would be much larger, in the $80 to $90 million range; finally, in the annual report for fiscal 1972, filed August 3, 1972, the company reported a loss of $90 million, and the company's independent auditors withdrew certification of the 1971 financial statements, and declined to certify those for 1972, because of doubts that the loss reported for 1972 was in fact suffered in that year.

Several suits were filed following the 1972 disclosures of Ampex's losses. They were consolidated for pre-trial purposes.

* The Honorable Elbert P. Tuttle, United States Court of Appeals Senior Circuit Judge for the Fifth Circuit, sitting by designation.

The named plaintiffs in the various complaints involved in these appeals[1] purchased Ampex securities during the 27 month period between the release of the 1970 and 1972 annual reports, and seek to represent all purchasers of Ampex securities during the period. The corporation, its principal officers during the period,[2] and the company's independent auditor are named as defendants. The gravamen of all the claims is the misrepresentation by reason of annual and interim reports, press releases and SEC filings of the financial condition of Ampex from the date of the 1970 report until the true condition was disclosed by the announcement of losses in August of 1972.

The plaintiffs moved for class certification shortly after filing their complaints in 1972; after extensive briefing and argument the district judge entered an order on April 11, 1974, conditionally certifying as a class all those who purchased Ampex securities during the 27 month period. The defendants filed notices of appeal from the order of certification on May 9 and 10, 1974.[3]

Additionally, the district judge, in an order entered July 1, 1974, denying a motion made by defendants Roberts and Buchan, and defendants Blackie, *et al.*, for reconsideration of the class certification, permitted those defendants to seek an interlocutory appeal from that order under 28 U. S. C. § 1292(b).[4]

1. The lead action here, the so-called *Molder* action, was originally filed in the Eastern District of Pennsylvania in January of 1972, and transferred to the Northern District of California, where it was consolidated for pretrial with seven other actions. Twelve parties have been allowed to intervene as plaintiffs in the *Molder* action.

2. Appellants Roberts and Buchan terminated their relationship with Ampex during the class period; the remaining individual defendants were in office throughout the period.

3. The direct appeals are designated Nos. 74-2141, 74-2341, 74-2167, and 74-2466.

4. The district court did not grant permission to appellants Touche and Ampex to seek interlocutory review, as they had not joined in the motion for reconsideration filed before the filing of

We granted the petition for interlocutory review.[5] That appeal was designated No. 74-2648, and consolidated with the direct appeals.

In December of 1974, plaintiffs filed a motion to dismiss the various appeals—the purportedly direct appeals on the ground that the certification order is not appealable under 28 U. S. C. § 1291, and the § 1292(b) appeal on the ground that it has been prosecuted in a dilatory manner.

The appeals having now been heard and submitted, we face three issues: 1) whether the order certifying the class is a final order appealable under § 1291; 2) whether the interlocutory appeal should be dismissed; and (if any of the appeals are properly before us) 3) whether the district court order certifying the class was proper under the standards set out in Fed. R. Civ. P. 23(a) and (b)(3). To summarize our decision, we hold the certification order non-appealable and dismiss the direct appeals; we deny the motion to dismiss the § 1292(b) certified appeals; and, on the merits, hold that the suit may properly be maintained as a class action.

I. *Appealibility under § 1291 of an order granting class action status.*

The courts of appeals have jurisdiction over appeals of right under 28 U. S. C. §1291 only from "final decisions" of the district courts. The statutory limitation is the product of a two-

---

their notices of appeal. The court assumed that the filing of the notices divested him of jurisdiction over those defendants. We reject Ampex's argument that it is here under § 1292(b) by virtue of its codefendant's interlocutory appeal and its own filing of a notice of appeal under Fed. R. App. P. 4. The taking of an interlocutory appeal requires a discretionary judgment by both the district court and court of appeals—that judgment is exercised with respect to particular parties. As a result, Fed. R. App. P. 5 does not provide, as does Rule 4, for parties to join in others' appeals.

5. Thus, whether the standards for certification of such an appeal set out in § 1292(b) were met has been decided, and is not now before us.

fold policy judgment about judicial administration which was written into the first Judiciary Act and adhered to ever since. *See Cobbledick* v. *United States*, 309 U. S. 323, 324-325 (1940). The requirement saves judicial time by eliminating review of rulings adverse to an eventually successful litigant. But more importantly, the uniform imposition of finality as a condition of review improves the quality of justice administered by the judicial system. On balance, the rule shortens the time needed for resolution of controversies, saving litigants both time and money; "[requiring finality avoids] the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment." *Cobbledick, supra*, at 325. In short, the rule is one of the primary bars against Bleak House Judicial administration;[6] as such, its rationale applies equally to an order certifying a class.

Nevertheless, in some circumstances deferring an appeal practically operates to deny effective review, as the right threatened by an adverse ruling will have been lost in the interim before final disposition of the other aspects of the controversy. The Court therefore has given the § 1291 final decision requirement a "practical rather than a technical construction." *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 341, 348 (1949), and allowed interlocutory appeal from a "small class [of orders] which finally determine claims of

6. A system of judicial administration, fortunately unknown in this country.

> "which has its ruined suitor, with his slipshod heels and threadbare dress, borrowing and begging through the round of every man's acquaintance; which gives to monied might, the means abundantly of wearying out the right; which so exhausts finances, patience, courage, hope; so overthrows the brain and breaks the heart; that there is not an honorable man among its practitioners who would not give—who does not often give —the warning. 'Suffer any wrong that can be done you, rather than come here!' "

Dickens, Bleak House, quoted in The World of Law—I, The Law *in* Literature 42 (E. London ed. 1960).

right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen*, at 546, *See Eisen* v. *Carlisle & Jacquelin*, 417 U. S. 156, 170-172 (1974) (*Eisen IV*); Note, *Class Action Certication Orders: An Argument for the Defendant's Right to Appeal*, 42 Geo. Wash. L. Rev. 621, 625-628 (1974). Two of the three circuits which have faced the issue have nevertheless held a class certification order non-appealable under *Cohen*. *Thill Securities Corp.* v. *New York Stock Exchange*, 469 F. 2d 14 (7th Cir. 1972); *Walsh* v. *City of Detroit*, 412 F. 2d 226 (6th Cir. 1969). *Accord*, 9 J. Moore, Federal Practice ¶ 110.13[9], at 184-187 (2d ed. 1970).

The Second Circuit, however, has permitted appeal in certain limited circumstances. In *Eisen* v. *Carlisle & Jacquelin*, 370 F. 2d 119 (2d Cir. 1966), *cert. denied*, 386 U. S. 1035 (1967) (*Eisen I*), that court recognized that an order denying class action status effectively sounded the "death knell" of the plaintiff's suit. As "no lawyer of competence is going to undertake this complex and costly case to recover $70 for Mr. Eisen," the individual claim could not be adjudicated, and as a practical matter the class question could never be appealed. The court therefore concluded the order was appealable under *Cohen*. We have adopted the death knell doctrine. *Falk* v. *Dempsey-Tegeler & Co., Inc.*, 472 F. 2d 142 (9th Cir. 1972); *Weingartner* v. *Union Oil Company of California*, 431 F. 2d 26 (9th Cir. 1970).

From that springboard the Second Circuit developed a "reverse death knell" doctrine with respect to a defendant and his rights to foreclose an ostensible class suit against him. Influenced by the suggestion that it consider a rule which would "afford equality of treatment as between plaintiffs and defendants" (*Korn* v. *Franchard Corp.*, 443 F. 2d 1301, 1307 (2d

Cir. 1971) (Friendly, J., concurring)), a panel of the circuit held in *Eisen* v. *Carlisle & Jacquelin*, 479 F. 2d 1005, 1007 n.1 (2d Cir. 1973) (*Eisen III*), that defendants could appeal an order granting class status under three specified conditions. As explicated in *Herbst* v. *International Telephone and Telegraph Corp.*, 495 F. 2d 1308, 1312 (2d Cir. 1974), such an order is appealable when the class determination is "fundamental to the further conduct of the case'" (*i.e.*, when, were the class determination reversed, the individual claims presented would be too small to continue the suit, thus effectively terminating it—the reverse death knell situation);[7] when the *order* is " 'separable from the merits;' " and when it will result in " 'irreparable harm to the defendant in terms of time and money spent in defending a huge class action.' " *Herbst*, at 1312, quoting from *Eisen III*, at 1007 n. 1. We are asked, the issue being novel in this circuit, to adopt the Second Circuit's position.[8]

We decline to do so, because we believe that the Second Circuit's rule impermissably[9] disregards the conditions placed

7. *See General Motors Corp.* v. *City of New York*, 501 F. 2d 639, 645 (2d Cir. 1974); *Kohn* v. *Royall, Koegal and Wells*, 496 F. 2d 1094, 1099 (2d Cir. 1974). *But see General Motors Corp., supra*, at 656-657.

8. Wholly aside from our disagreement with the Second Circuit rule, we doubt that the order involved here would be appealable under that rule. Including intervenors, the named plaintiffs purchased 10,000 shares during the class period and damages would appear to be such that the action would proceed were the order reversed. Thus, criteria 1 may not be satisfied. *See, e.g., Falk, supra*, (holding individual claim of $14,125 too large to invoke death knell doctrine); *Shayne* v. *Madison Square Garden Corp.*, 491 F. 2d 397 (2d Cir. 1974) (individual claim of $7,482 too large); *Milberg* v. *Western Pacific R. R.*, 443 F. 2d 1301 (2d Cir. 1971) ($8,500 claim too large). Moreover, in this case the second criteria is probably not met either. *See Kohn, supra*, at 1099; *General Motors Corp., supra*, at 646, 659.

9. We recognize that it is not altogether certain that the *Cohen* standards represent the outer parameters of appealability, in light of the Court's admonition in that case to give the final decision rule a

on appealability by *Cohen*. The rule of finality is a statutorily imposed restraint on our jurisdiction; as noted, it imposes a legislative judgment that on balance time and money will be saved if appeal is deferred until the conclusion of a suit. We are not free to disregard that judgment; exceptions to uniform application undermine the rule's purpose by fostering litigation about whether an order is exceptional and appealable. And with the proliferation of narrow and peculiar exceptions, the more doubtful and difficult it becomes to determine appealability, at district and appellate court levels, increasingly inviting supposedly foreclosed interlocutory litigation.

In this view, and while recognizing that it is nevertheless such an exception, we think the *Cohen* "collateral order" standards should be restrictively construed. The *Cohen* rule is an effort to prevent the inevitable injustices to litigants which result from application of a prophylactic rule which operates "on balance," but only in those limited situations where it can be accomplished with a minimum intrusion on the statutory policy. Thus, *Cohen* requires not only that denial of immediate review results in loss of a right which cannot be sustained by later review, but also that the order appealed from be final and collateral. Thus, even when an injustice may result, immediate review is available only when the appellate court will not be required to duplicate efforts entailed in a later review on the merits, or to review a decision whose tentative nature will render the appellate court's decision fruitless later in the lawsuit.

We are clear that a class certification order does not fall within *Cohen*. The finality condition is not met, as such an

---

practical rather than technical construction, and its later observation in *Eisen IV*, at 170, that "[n]o verbal formula yet devised can explain prior finality decisions with unerring accuracy or provide an utterly reliable guide for the future." However, we think those standards were so intended and should be so read, for the same reasons that we think the *Cohen* exception was intended to be narrowly construed, which we set out below.

order is not a final determination of the propriety of a class. Under Fed. R. Civ. P. 23(c)(1), a class must be certified as soon as practicable after commencement of the action, and is made conditional and subject to alteration, to the creation of sub-classes, Rule 23(c)(4)(B), or indeed to decertification as the suit progresses and newly discovered facts warrant.[10] Nor is the class issue separable from the merits in all cases (including this one). The common questions, typicality, conflicts and adequacy of representation, Fed. R. Civ. P. 23(a), and predominance tests, Fed. R. Civ. P. 23(b)(3), are determinations (unlike, for example, the notice question involved in *Eisen IV*) which may require review of the same facts and the same law presented by review of the merits.[11]

Nor, for that matter, does the order threaten the defendant with any irreparable harm cognizable under *Cohen*. The defendant does not lose any legal rights or entitlement in the interim between certification and appeal—appeal after the litigation fully protects from a judgment for an improper class. *See* Geo. Wash. Note, *supra*, at 628-630.

The Second Circuit found the requisite injury in the increased, and generally irrecoverable, costs of defending the class action. With deference, we disagree. The final decision rule itself often increases the time and cost of litigation. Denial of immediate review from orders denying motions to dismiss, Fed. R. Civ. P. 12(b)(6), or for summary judgment, Fed. R.

10. "But we do not mean that every order fixing security is subject to appeal. Here it is the right to security that presents a serious and unsettled question. If the right were admitted or clear and the order involved only an exercise of discretion as to the amount of security, a matter the statute makes subject to reconsideration from time to time, appealability would present a different question." *Cohen*, at 547.

11. *See Kohn*, *supra* at 1099; *General Motors Corp.*, *supra*, at 659. In fact, as a ruling on class certification must be made soon after commencement of the action, the facts governing the class determination will inevitably be less clear than after the case has gone to judgment.

Civ. P. 56, may subject a defendant in particular cases to defense costs equivalent to those incurred in defending a class action. Geo. Wash. Note, *supra*, at 629-630; *Kohn* v. *Royall, Koegel & Wells*, 496 F. 2d 1094, 1098-1099 (2d Cir. 1974). Such litigants must bear those costs because of the legislative judgment that a final decision rule will most benefit all litigants, statutorily foreclosing reliance on litigation costs as a justification for departure from the final decision rule.[12]

It strikes us that the Second Circuit rule is the product of three policy considerations, urged on us here as well, which we conclude are insufficient to justify departure from the *Cohen* gloss on the rule.

The first is that litigation costs will be reduced by allowing appeal and thus avoiding the substantial costs of litigating an improperly certified class. While perhaps true in a particular suit, we suspect that the savings envisioned may well prove illusory. Applied to all class actions, the Second Circuit's rule saves time and money only when the appellate court determines the particular class certification order is appealable, when the order would not have been otherwise appealable under the narrower *Cohen* exception, when the district judge would have refused to certify a § 1292(b) appeal, where the district judge would not later decertify the class, and where, on the merits, the order is reversed. Even then later developments in the suit may lead to reinstatement of the class. To be balanced against savings is the loss of time and money resulting from appeal in which the order is held non-appealable, or the order is affirmed. Neither we nor (we suggest) the Second Circuit have any way of striking that balance. We can only speculate concerning the various costs, time spans, and percentages which must necessarily be appraised to determine whether the Second Circuit's

12. Neither *Cohen* nor *Eisen IV* support the Second Circuit in this regard. In both cases the defendant was threatened with costs which the applicable statute placed on the plaintiff. In neither case did the Court rely on general litigation expense to justify appealability.

exception could pay its way; it is ultimately a question which is best suited to legislative investigation and judgment.

Moreover, we would suggest that the number of suits in which a rule of appealability would be worthwhile may be relatively small. The standard of review is abuse of discretion. A number of the criteria set out in Rule 23 relate to matters, such as manageability, adequacy of representation, feasibility of joinder, superiority to other available methods of adjudication, and the like, which are much more within the knowledge of the district court in touch with the litigation than in ours; our review is unlikely to add any superior wisdom, or to reverse on those grounds. In those cases which turn on a question of law, the district judge may certify an interlocutory appeal.[12a] The number of cases in which massive litigation costs are threatened, in which a district judge declines to certify an appeal, and which thereafter results in reversal of the class certification, may prove small indeed.

The second consideration is that, because the "death knell" doctrine allows plaintiffs to appeal orders denying class status, parity of treatment requires that defendants be allowed to appeal orders granting such status. We disagree. Precisely the same disparity exists between plaintiffs and defendants with regard to summary judgment or motion to dismiss orders. So long as they are differently situated in a manner relevant to the purposes of the final decision rule, plaintiffs and defendants may be treated differently. Suffice it here to say that they are differently situated with respect to the finality of the class order—an order denying in the "death knell" situation effectively terminates the suit and precludes presentation of the merits; an order granting does not end the suit, or preclude

12a. Generally an order granting class action status does not involve a controlling question of law when entered because it has no significant effect on the litigation until issues not pertaining to the personal claims of the class representative have to be decided. Note, *Interlocutory Appeals in the Federal Courts Under 28 U. S. C. §1292(b)*, 88 Harv. L. Rev. 607, 630-631 n. 97 (1975).

presentation of the defense, and is subject to reevaluation as well. *See* Geo. Wash. Note, *supra*, at 631-632.

The final consideration relied on by the Second Circuit, *see Herbst, supra*, at 1313, strenuously urged here, is that a class certification order in a large-class, small-claim class action threatens such ruinous liability that the defendant inevitably must settle even frivolous claims, thereby effectively precluding review of the crucial class certification order unless interlocutory review is allowed. Again, we are unpersuaded. In large part the argument is an attack on the decision reflected in Rule 23 to allow integration of numerous small individual claims into a single powerful unit, rather than to an attack peculiarly germane to the operation of the final decision rule in the class action context. Precisely the same power to coerce a settlement (and defeat review of potentially erroneous previous orders) is wielded by any plaintiff with a substantial claim—that fact alone does not generally confer appealability on an order which effectively requires a defense to a large claim. The fairness of the pressure—*i.e.*, the sociological merits of the small claims class action—is not a question for us to decide. The fact is that Congress, by authorizing and approving Rule 23(b)(3), created a vehicle to put small claimants in an economically feasible litigating posture. In that light, we doubt the propriety of an attendant judicial alteration of the final decision rule which immediately (and uniquely) subjects redress of class plaintiffs' claims to the delay and cost of an appeal.

We recognize, of course, that it is the class certification order itself which, if erroneous, creates the improper coercive effect. That is a distinction without a difference unless class certification orders have unique effects specially implicating the policy of the final decision rule. It may well be that a higher percentage of class certification orders are erroneous than others which subject a defendant to the coercion of a large potential liability; or that a higher percentage of frivolous claims are presented

in class actions than in others; or that the magnitude of the potential liability in class actions is leading to settlement of more frivolous claims and abandonment of more meritorious appeals, than occurs in other litigation. If such is not the case, there is no reason to treat a class certification order differently than any other interlocutory order. If so, an exception may or may not be justified.[13]

In either event, however, the argument is again properly addressed to Congress. We have no reliable knowledge,[14] and no good means of acquiring any, about the present nature and number of class action settlements, and of how that experience compares with individual lawsuits of the same type, or pressing claims of similar magnitude. Thus, we have no means of deciding whether the present hue and cry of "blackmail" in fact reflects an abnormally high incidence of unfairly coerced settlements, or is rather the pained outcry of defendants whose previously advantaged litigating position has been undermined,

13. We note that the supposed *in terrorem* effect of the class certification will persist despite a right of immediate appeal—the claim may be frivolous and the class proper. Immediate appeal will eliminate only the improperly certified coercive class action, at the expense of both frivolous and non-frivolous, property certified classes. It may well be better to attack the "blackmail" problem directly with appropriate safeguards rather than collaterally undermining the final decision rule.

14. Both sides have cited extensive commentary, by courts and critics alike, on the supposed *in terrorem* effect of class actions. Almost inevitably those opinions are supported by highly inconclusive, or no, empirical evidence; most of the debate is founded on speculation, primarily dictated by the writer's personal experience and feelings for or against class actions. The empirical evidence on the subject is very limited, and not particularly helpful because it provides no basis for comparison of class actions with other suits. For what it is worth, however, the empirical evidence indicates that a relatively high proportion of class actions are not settled, but disposed of in defendant's favor on preliminary motions. *See* Committee on Commerce, United States Senate, *Class Action Study*, 93d Cong., 2d Sess. (1974), Committee Print at 9-10. On the basis of the evidence before it, the Commerce Committee concluded that the class action was not a particularly effective vehicle for coercing settlements.

and who must now confront small claimants (who have been given the capacity to exert pressure proportionate to the magnitude of the total injury occasioned by defendant's alleged violation of the law) on more equal grounds. Without such knowledge, there is no justification for departure from the "final decision" rule in this context, and we decline to do so.

Consequently, the § 1291 appeals designated Nos. 74-2141, 74-2167, 74-2341 and 74-2466 are dismissed.

II. *The § 1292(b) interlocutory appeals.*

We deny the motion to dismiss the § 1292(b) appeals.

The prosecution of these appeals has not been a model of diligence. Defendants were granted an extension of the time to transmit the record, and three extensions in the briefing schedule. Some of those delays could have been avoided; while the issues involved are somewhat complex, we note that much of the material in the appellate briefs was presented to the trial court, and that the lawyers did not start from scratch here.

However, the motion to dismiss is addressed to our discretion, and we think dismissal is not mandated in this case. From the somewhat conflicting representations before us it appears that appellees may have agreed to the extensions, although that acquiescence may have been induced by a now disclaimed representation that plaintiffs could continue with discovery while the case was on appeal. Because the record is hazy, because we have granted the extensions, and because the issues have now been briefed and argued and are ripe for decision, we think the preferable course is for us to decide the appeal and provide guidance to the trial court. However, we do note that one purpose of interlocutory appeals is to hasten the conclusion of a lawsuit, that briefing extensions defeat that purpose, and that in appropriate circumstances we can deny unwarranted extensions and dismiss appeals to prevent an interlocutory appeal from being misused as a dilatory tactic.

We turn to the merits of defendants' Buchan and Roberts, and Blackie, et al., § 1292(b) appeals.

III. *Compliance with the Requirements of Fed. R. Civ. P. 23(a) and (b)(3).*

A. The court's approach to class certification.

As a preliminary matter, we face the contention that the district judge certified the class in an inappropriate manner. Relying on our opinion in *In re Hotel Telephone Charges*, 500 F. 2d 86, 90 (9th Cir. 1974) defendants argue that he improperly engaged in speculation when determining whether a common question exists, and whether conflicts make class representation inadequate, rather than determining, before certifying the class, that the requirements of the Rule were in fact met. We disagree.

From a thorough review of the district judge's opinion, we think it apparent that he analyzed the allegations of the complaint[15] and the other material before him (material sufficient to form a reasonable judgment on each requirement), considered the nature and range of proof necessary to establish those allegations, determined as best he was able the future course of the litigation and then determined that the requirements were met at that time.[16] That is all that is required.

---

15. In large part appellants' attack on the district judge's approach is a reiteration of their disagreement with his legal conclusions. The speculative language seized upon in the opinion simply conditions the conclusion that a common question exists on plaintiffs' proof of the allegations—*i.e.*, if plaintiffs prove their allegation of X, X will be a question of fact or law common to the class. Such speculation is entirely proper and necessary. Likewise, the court ruled that any conflicts at present did not appear to defeat adequacy of representation, but that if any unforeseen difficulties arose, they could be cured by sub-classes—again a proper application of the Rule.

16. The court is bound to take the substantive allegations of the complaint as true, thus necessarily making the class order speculative in the sense that the plaintiff may be altogether unable to prove his allegations. While the court may not put the plaintiff to preliminary

Defendants misconceive the showing required to establish a class under *Hotel Telephone Charges*. We indicated there that the judge may not conditionally certify an improper class on the basis of a speculative possibility that it may later meet the requirements. 500 F. 2d at 90. However, neither the possibility that a plaintiff will be unable to prove his allegations, nor the possibility that the later course of the suit might unforeseeably prove the original decision to certify the class wrong, is a basis for declining to certify a class which apparently satisfies the Rule. The district judge is required by Fed. R. Civ. P. 23(c)(1) to determine "as soon as practicable after the commencement of an action brought as a class action . . . whether it is to be so maintained." The Court made clear in *Eisen IV* that the determination does not permit or require a preliminary inquiry into the merits, 417 U. S. at 177-178; thus, the district judge is necessarily bound to some degree of speculation by the uncertain state of the record on which he must rule. An extensive evidentiary showing of the sort requested by defendants is not required. So long as he has sufficient material before him to determine the nature of the allegations, and rule on compliance with the Rule's requirements, and he bases his ruling on that material, his approach cannot be faulted because plaintiffs' proof may fail at trial. Of course, whether he applied correct legal principles in making the ruling, and whether the ruling was within the permissible boundaries of the discretion vested in him, is another question, to which we now turn.

---

proof of his claim, it does require sufficient information to form a reasonable judgment. Lacking that, the court may request the parties to supplement the pleadings with sufficient material to allow an informed judgment on each of the Rule's requirements.

B. The merits of class certification.

Defendants question this suit's compliance with each of the various requirements of Rule 23(a) and (b)(3)[17] except numerosity (understandably, as it appears that the class period of 27 months will encompass the purchasers involved in about 120,000 transactions involving some 21,000,000 shares). However, all of defendants' contentions can be resolved by addressing 3 underlying questions: 1) whether a common question of law or fact unites the class; 2) whether direct individual proof of subjective reliance by each member is necessary to establish 10b-5 liability in this situation; and 3) whether proof of liability or damages will create conflicts among class members and with named plaintiffs sufficient to make representation inadequate? We turn to the first issue.

---

17. Rule 23 provides in part:

"(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

"(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

* * * *

"(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

1. Common questions of law or fact.

The class certified runs from the date Ampex issued its 1970 annual report until the company released its 1972 report 27 months later. Plaintiffs' complaint alleges that the price of the company's stock was artificially inflated because:

> "the annual reports of Ampex for fiscal years 1970 and 1971, various interim reports, press releases and other documents (a) overstated earnings, (b) overstated the value of inventories and other assets, (c) buried expense items and other costs incurred for research and development in inventory, (d) misrepresented the companies' current ratio, (e) failed to establish adequate reserves for receivables, (f) failed to write off certain assets, (g) failed to account for the proposed discontinuation of certain product lines, (h) misrepresented Ampex's prospects for future earnings."

The plaintiffs estimate that there are some 45 documents issued during the period containing the financial reporting complained of, including two annual reports, six quarterly reports, and various press release and SEC filings.

Because the alleged misrepresentations are contained in a number of different documents, each pertaining to a different period of Ampex's operation, the defendants argue that purchasers throughout the class period do not present common issues of law or fact. They reason that proof of 10b-5 liability will require inspection of the underlying set of facts to determine the falsity of the impression given by any particular accounting item presented; that the underlying facts fluctuate as the business operates (*i.e.*, inventory is bought and sold, accounts are paid off and created); thus, proof of the actionability of a current accounting representation or omission will apply only to those who purchased while a financial report was current; from which they conclude no common question is presented and a class is improper.

We disagree. The overwhelming weight of authority holds that repeated misrepresentations of the sort alleged here satisfy the "common question" requirement. Confronted with a class of purchasers allegedly defrauded over a period of time by similar misrepresentations, courts have taken the common sense approach that the class is united by a common interest in determining whether a defendant's course of conduct is in its broad outlines actionable, which is not defeated by slight differences in class members' positions, and that the issue may profitably be tried in one suit. *See Green* v. *Wolf Corporation,* 460 F. 2d 291, 298 (2d Cir. 1968); *Esplin* v. *Hirschi,* 402 F. 2d 94 (10th Cir. 1968); *Harris* v. *Palm Springs Alpine Estates,* 329 F. 2d 909 (9th Cir. 1964); *U. S. Financial Securities Litigation,* 64 F. R. D. 433 (S. D. Cal. 1974); *Aboudi* v. *Daroff,* 65 F. R. D. 388 (S. D. N. Y. 1974); *Werfel* v *Kramarsky,* 61 F. R. D. 674 (S. D. N. Y. 1974); *In re Memorex Security Cases,* 61 F. R. D. 88 (N. D. Cal. 1973); *Siegel* v. *Realty Equities Corporation of New York,* 54 F. R. D. 420 (S. D. N. Y. 1972); *Herbst* v. *Able,* 47 F. R. D. 11 (S. D. N. Y. 1969); *Dolgow* v. *Anderson,* 43 F. R. D. 472 (E. D. N. Y. 1968); *Siegel* v. *Chicken Delight, Inc.,* 271 F. Supp. 722 (N. D. Cal. 1967); *Fischer* v. *Kletz,* 41 F. R. D. 377, 381 (S. D. N. Y. 1966); *Kronenberg* v. *Hotel Governor Clinton, Inc.,* 41 F. R. D. 42 (S. D. N. Y. 1966). As we stated in *Harris, supra*:

> "Appellees assert that the various investors made payments on the securities at different times and stand in different positions . . . [S]ince the complaint alleges a common course of conduct over the entire period, directed against all investors, generally relied upon, and violating common statutory provisions, it sufficiently appears that the questions common to all investors will be relatively substantial." 329 F. 2d at 914.

Those views are consistent with the views of the Advisory Committee on the Rule: "[A] fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action . . ." Advisory Committee

on Rule 23, Proposed Amendments to the Rules of Civil Procedure, 39 F. R. D. 69, 103 (1966). The availability of the class action to redress such frauds has been consistently upheld, *see In re Caesars Palace Securities Litigation*, 360 F. Supp. 366, 395-96 (S. D. N. Y. 1973), in large part because of the substantial role that the deterrent effect of class actions plays in accomplishing the objectives of the securities laws. *See* III Loss, Securities Regulation 1819 (2d ed. 1961) ("the ultimate effectiveness of [the security antifraud laws] may depend on the applicability of the class action device").

While the nature of the interrelationship and the degree of similarity which must obtain between different representations in order to come within the outer boundaries of the "common course of conduct" test is somewhat unclear,[18] the test is more

18. Because plaintiffs have alleged specific strands of misrepresentation running throughout financial statements of the class period, they are well within whatever the outer boundaries might be, and we need not resolve the issue. We note, however, that a number of courts have apparently held that allegations simply that earnings and stock price have been inflated over a period of time by a defendant's misrepresentations is sufficient to satisfy the common question requirement (although the cases are somewhat unclear because they fail to specify the precise misrepresentations which allegedly inflated earnings). *See Fischer* v. *Kletz, supra; Kronenberg, supra; Werfel* v. *Kramarsky, supra. See Feldman* v. *Lifton*, 64 F. R. D. 539, at 544-545 (S. D. N. Y. 1974). Appellants point out that allegation of inflation of earnings or price is conclusionary, and may derive from altogether unrelated misrepresentations. In their view the common question requirement is met only if all purchasers are injured by the same misrepresentation, or, in a "course of conduct" case, by identical repeated misrepresentations, and if defendant's liability can be established by proof both of the same set of facts and same legal principle. We think that is far too restrictive a view of the common question requirement in the securities fraud context. Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; it may also be predicated on a "practice, or course of business which operates . . . as a fraud . . ." Under that section class members may well be united in establishing liability for fraudulently creating an illusion of prosperity and false expectations.

Moreover, even when misrepresentations are unrelated, class members may share a common question of law or fact. Of course, if an early misrepresentation is undissipated, a later purchaser will present

(Footnote continued on next page)

than satisfied when a series of financial reports uniformly misrepresent a particular item in the financial statement. In that situation, the misrepresentations are "interrelated, interdependent, and cumulative;" [L]ike standing dominoes . . . one misrepresentation . . . cause[s] subsequent statements, to fall into inaccuracy and distortion when considered by themselves or compared with previous misstatements." *Fischer* v. *Kletz, supra,* at 381.

Precisely such a situation is alleged here in at least three respects—the failure to create adequate reserves for uncollectible accounts receivable and for contractually guaranteed royalty payments, and the over-statement of inventory. The 1972 Annual Reports shows writedowns of $31.9 million as provision for royalty guarantees, $11.8 million for uncollectible accounts receivable, and $15 million for inventory. Plaintiffs allege that the writedowns had roots tracing back to the begin-

---

a common question even if another misrepresentation has intervened. But even if the effect of the earlier misrepresentation is dissipated, proof of the earlier misrepresentation may be relevant to the latter purchaser's case. Proof of the earlier fraud and its effects might be relevant circumstantially to establish duty standards, culpability, or damages regarding the later fraud; it would establish background information about the defendant common to both suits. Thus, even when unrelated misrepresentations are alleged as part of a common scheme, class members may share common factual questions, and trial in the same forum avoids duplicative proof. That is a major purpose of a class action; the "common question" requirement should be interpreted to obtain that objective. Naturally, when the component misrepresentations of a "course of conduct" fraud are unrelated, a great many more non-common questions exist. In that situation no representative's claim may be typical of the rest of the class, Rule 23(a)(3), although that depends on how broadly that requirement is construed. *See* text at note 25, *infra,* and note 25 *infra.* We think it is for the predominance and other requirements of Rule 23(b)(3), rather than the common question requirement, to function to keep the balance between the economies attained and lost by allowing a class action. The common question requirement should not be restrictively interpreted to attain that objective, particularly as to do so would eliminate the class action deterrent for those who engage in complicated and imaginative rather than straightforward schemes to inflate stock prices.

ning of the class period, an allegation somewhat borne out by the auditors' withdrawal of certification of the 1971 report because of uncertainty that the huge losses reported in 1972 were the product of 1972 business operations, and not attributable to earlier years. Plaintiffs contend that the company's financial reports throughout the period uniformly and fraudulently failed to establish reserves in amounts adequate to satisfy accepted accounting principles, injuring all purchasers of the consequently inflated stock.

In this aspect, plaintiffs allege a source of inflation common to every purchaser. The creation of a reserve is of course simply an adjustment made to the balance sheet and income statement to provide a more realistic view of the business and its operations. Failure in any particular period to recognize that a portion of the accounts receivable generated in that period are uncollectible, and to create or adjust a reserve, will have the effect of inflating the balance sheet assets and surplus, and overstating the income for the period; likewise failure to recognize accrued liabilities for royalty payments will inflate surplus by understating liabilities, and will overstate income. Naturally, any inflation in the stock price due to inadequate reserves will persist until the reserves become adequate or until the losses are in fact written off.

Defendants nevertheless contend that a class is improper because each purchaser must depend on proof of a different set of accounting facts to establish the inadequacy of the reserves at the time he bought. Defendants misconceive the requirement for a class action; all that is required is a common issue of law *or* fact. Even were we to assume that the reserves were at some points during the period adequate, the class members still would be united by a common interest in the application to their unique situation of the accounting and legal principles requiring adequate reserves—*i.e.*, by a common question of law.[19] Here, how-

19. Appellants make much of the distinction between an accounting principle and estimate, arguing that the exercise of judg-

(Footnote continued on next page)

ever, in light of the progressive deterioration of Ampex's financial position and the magnitude of the losses at the end of the period, even the fact that reserves were in reality inadequate throughout much if not all of the period may not be in serious dispute; rather, the question will be whether the inadequacy was in some sense culpable because the contingencies which proved them inadequate were foreseen or foreseeable.

The alleged inventory overvaluation likewise presents common issues. Defendants again contend it does not because the valuation of any particular period's closing inventory involves a process of physical estimation based on that inventory's characteristics, and that overstatement of one period's closing inventory, while overstating that period's income, will have an opposite effect on the next period's income by overstating opening inventory, deflating rather than inflating stock price. While true in abstract, appellants' position disregards the real substance of the plaintiffs' complaint which is again highlighted by the 1972 Report. In explaining the $15 million writedown, the company stated: "Inventories of stereo tapes more than six months old and more than one year old were written down 50% and 100% respectively . . . No significant writedowns of this nature were made in the prior year."

Plaintiffs thus are complaining of the balance sheet effect of inventory over-valuation. They are alleging that by failing

---

ment involved in an estimate depends on analysis of facts which change, making legal evaluation of different estimates distinct legal and factual problems. The distinction makes little sense in this context. The judgment necessary to make an estimate must be controlled by the accounting principle. Thus, even when only detached, unconnected incidents of incorrect estimates are alleged, the jury must nevertheless be apprised of the common standard of law by which to judge the estimates—the accounting principle—and a common question is presented. Insofar as a class action is involved, the situation is the same as where a consistent misapplication of an accounting principle as part of a course of conduct to inflate the stock price is alleged. And, moreover, it appears to us, contrary to appellants' contentions, that plaintiffs are complaining of abuses of accounting principles, not estimates.

throughout the class period to recognize and account for inventory obsolescence each time the inventory was valued, the company consistently inflated the value at which it carried inventory on the balance sheet.[20] In effect, plaintiffs are complaining of a consistent disregard of the accounting principle that inventory be valued at "lower of cost or market." Again, common questions of law and facts are presented.

The class members also share an interest in establishing the standard of care required of the various defendants under the *White* v. *Abrams,* 495 F. 2d 724 (9th Cir. 1974), flexible duty standard. The flexible duty of any defendant, while depending on his particular relationship to Ampex and to the financial reporting involved, will be owed identically to all market purchasers, who are for practical purposes identically situated. The culpability of each defendant's conduct is to be measured against the statutorily imposed duty not to manipulate the market. Differences in sophistication, etc., among purchasers have no bearing in the impersonal market fraud context, because dissemination of false information necessarily translates through market mechanisms into price inflation which harms each purchaser identically. *See U. S. Financial Securities Litigation, supra,* at 451-452.

Moreover, because of the relative similarity of the various documents involved, the duty owed by a defendant with respect to such documents will probably be uniform or nearly so, further uniting the positions of all class purchasers.

2. Predominance and reliance.

Defendants contend that any common questions which may exist do not predominate over individual questions of reliance and damages.

The amount of damages is invariably an individual question and does not defeat class action treatment. *E.g., U. S. Financial*

20. Whether inflation of assets rather than earnings is material to the stock price is for the jury, not us, to decide.

Securities Litigation, supra, at 448 n. 5, and cases there cited. Moreover, in this situation we are confident that should the class prevail the amount of price inflation during the period can be charted and the process of computing individual damages will be virtually a mechanical task. *See* n. 24 *infra.*

Individual questions of reliance are likewise not an impediment—subjective reliance is not a distinct element of proof of 10b-5 claims of the type involved in this case.

The class members substantive claims either are, or can be, cast in omission or non-disclosure terms—the company's financial reporting failed to disclose the need for reserves, conditions reflecting on the value of the inventory, or other facts necessary to make the reported figures not misleading. The Court has recognized that under such circumstances

> "involving primarily a failure to disclose, positive proof of reliance is not a pre-requisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." (citations omitted)

Affiliated Ute Citizens of Utah v. *United States,* 406 U. S. 128, 153-154 (1972). *See U. S. Financial Securities Litigation, supra,* at 451; *Caesars Palace Securities Litigation, supra,* at *supra,* at 339; *In re Penn Central Securities Litigation,* 347 F. Supp. 1327, 1344 (E. D. Penn. 1972).

Moreover, proof of subjective reliance on particular misrepresentations is unnecessary to establish a 10b-5 claim for a deception inflating the price of stock traded in the open market. *See Herbst* v. *I. T. T., supra,* at 1315-1316; *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F. 2d 341, 373-374 (2d Cir. 1973); *Tucker* v. *Arthur Andersen & Co.,* CCH Fed. Sec. L. Rep. ¶ 95,107, at 97,934-97,935 (S. D. N. Y. 1975); *U. S. Financial Securities Litigation, supra,* at 449-451; *Werfel* v.

Kramarsky, supra, at 681; *In re Memorex Security Cases, supra,* at 100-101; *Siegel* v. *Realty Equities Corporation of New York, supra,* at 424-425; *Herbst* v. *Able, supra,* at 20. Proof of reliance is adduced to demonstrate the causal connection between the defendant's wrongdoing and the plaintiff's loss. We think causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of misrepresentations, without direct proof of reliance. Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price—when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case. *See In re Memorex Security Cases, supra,* at 101: Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5,* 88 Harv. L. Rev. 584, 593 (1975).

Defendants argue that proof of causation solely by proof of materiality is inconsistent with the requirement of the traditional fraud action that a plaintiff prove directly both that the reasonable man would have acted on the misrepresentation (materiality), and that he himself acted on it, in order to establish the defendant's responsibility for his loss, which justifies the compensatory recovery.

We disagree. The 10b-5 action remains compensatory; it is not predicated solely on a showing of economic damage (loss causation). We merely recognize that individual "transactional causation" can in these circumstances be inferred from the materiality of the misrepresentation, *see Tucker* v. *Arthur Andersen & Co., supra,* at 97,933; *Schlick* v. *Penn-Dixie Cement Corp.,* 507 F. 2d 374, 381-382 (2d Cir. 1974), and shift to defendant the burden of disproving a prima facie case of causation. Defendants may do so in at least 2 ways: 1) by disproving materiality or by proving that, despite materiality, an insufficient number of traders relied to inflate the price; and 2) by proving that an individual plaintiff purchased despite knowledge

of the falsity of a representation, or that he would have, had he known of it.[21]

That the prima facie case each class member must establish differs from the traditional fraud action, and may, unlike the fraud

21. A number of cases indicate that proof of materiality raises a "presumption" of reliance. The Court did not speak of a presumption in *Mills* or *Affiliated Ute;* we prefer to recognize that materiality directly establishes causation more likely than not, and that reliance as a separate requirement is simply a milepost on the road to causation. The net result is in either view the same: the validity of either view turns on the assumption that the particular investor is more likely to act like the reasonable investor than not.

There is some debate as to whether the "presumption" of reliance may be rebutted; the general view is that it may be, *see* Harvard Note, *supra,* at 600 and 600 n. 75, and cases there cited, although sound contrary opinion exists. *See Herbst* v. *IIT, supra,* at 1316 n. 14; *Chris-Craft Industries, Inc., supra,* at 400 (Mansfield, J., concurring and dissenting). The 10b-5 private suit serves a public purpose, but has done so since its judicial creation in the framework of a private damage suit. We doubt the right to disprove causation will substantially reduce a defendant's liability in the open market fraud context, as we doubt that a defendant would be able to prove in many instances to a jury's satisfaction that a plaintiff was indifferent to a material fraud. Nevertheless, we think the public purpose can be adequately served within the traditional compensatory suit framework by limiting recoveries to those who are in fact injured, and excluding those whom a defendant proves have not been injured, and that 10b-5 suits should continue in that mold until a contrary need appears or until the Court directs otherwise.

The right of rebuttal, however, does not preclude the predominance of common questions. Causation as to each class member is commonly proved more likely than not by materiality. That showing will undoubtedly be conclusive as to most of the class. The fact that a defendant may be able to defeat the showing of causation as to a few individual class members does not transform the common question into a multitude of individual ones; plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all.

The right to disprove causation will not render the action unmanageable. A defendant does not have unlimited rights to discovery against unnamed class members; the suit remains a representative one. *See Clark* v. *Universal Builders, Inc.,* 501 F. 2d 324 (7th Cir. 1974); *Gardner* v. *Awards Marketing Corporation,* 55 F. R. D. 460 (D. Utah 1972); *Fischer* v. *Wolfinbarger,* 55 F. R. D. 129 (W. D.

action, be established by common proof, is irrelevant; although derived from it, the 10b-5 action is not conterminous with a common law fraud action. As we recently recognized in *White* v. *Abrams*, the fraud action must be and has been flexibly adopted to the overriding purpose of enforcing the Federal securities laws. 495 F. 2d at 731. *See Affiliated Ute, supra,* at 151; *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 12 (1971); *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970); *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180, 186, 195 (1963).

Here, we eliminate the requirement that plaintiffs prove reliance directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden. A purchaser on the stock exchanges may be either unaware of a specific false representation, or may not directly rely on it, he may purchase because of a favorable price trend, price earnings ratio, or some other factor. Nevertheless, he relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the

Ky. 1971). The district judge may reasonably control discovery to keep the suit within manageable bounds, and to prevent fruitless fishing expeditions with little promise of success. He may also exercise discretion in the conduct of the trial, to prevent a time-consuming series of mini-trials on causation, by limiting introduction of repetitive evidence, or by limiting evidence to instances where causation is in doubt; he may also postpone trial of the rebuttal of individual causation until the damage stage of the trial; indeed, he has extensive powers to expedite the suit with procedural innovations. *See* Rule 23(d). We think procedures can be found and used which will provide fairness to the defendants and a genuine resolution of disputed issues while obviating the danger of subverting the class action with delaying and harassing tactics. If not, we may have to reconsider whether to make proof of causation from materiality conclusive, keeping in mind that the Court has directed that the statute be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an overinclusive recovery to a defrauded class if the unavailability of the class device renders the alternative a grossly underinclusive recovery.

price he pays reflects material misrepresentations. Requiring direct proof from each purchaser that he relied on a particular representation when purchasing would defeat recovery by those whose reliance was indirect, despite the fact that the causational chain is broken only if the purchaser would have purchased the stock even had he known of the misrepresentation. We decline to leave such open market purchasers unprotected. The statute and rule are designed to foster an expectation that securities markets are free from fraud—an expectation on which purchasers should be able to rely.

Thus, in this context we think proof of reliance means at most a requirement that plaintiff prove directly that he would have acted differently had he known the true facts. That is a requirement of proof of a speculative negative (I would not have bought had I known) precisely parallel to that held unnecessary in *Affiliated Ute* and *Mills* (I would not have sold had I known). We reject it here for the same reasons. Direct proof would inevitably be somewhat pro-forma, and impose a difficult evidentiary burden, because addressed to a speculative possibility in an area where motivations are complex and difficult to determine. That difficulty threatens to defeat valid claims—implicit in *Affiliated Ute* is a rejection of the burden because it leads to underinclusive recoveries and thereby threatens the enforcement of the securities laws. *See* Harv. Note, *supra,* at 590-91. Here, the requirement is redundant—the same causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.[22] Under those circumstances we think it appropriate to eliminate the burden.

22. *Raschio* v. *Sinclair,* 486 F. 2d 1029 (9th Cir. 1973), is in no way inconsistent with our present position. There we dealt with the statutory "in connection with" requirement, and held that it could not be met as a matter of law when the stock was purchased two months before the allegedly fraudulent representation was made. Here we do not retreat from that position, or from the implicit re-

Defendants contend that elimination of individual proof of subjective reliance alters and abridges their substantive rights in violation of the Rules Enabling Act, 28 U. S. C. § 2072. The obvious answer is that the standards of proof of causation we have set out apply to all fraud on the market cases, individual as well as class actions. No interpretation of Rule 23 is involved, and the Rules Enabling Act limitation is not implicated.[23]

C. Conflicts

Defendants' final major argument is that conflicts among class members preclude class certification. They contend that the interests of class members in proving damages from price inflation (and hence the existence and materiality of misrepresentations subsumed in proving inflation) irreconcilably conflict, because some class members will desire to maximize the inflation existing on a given date while others will desire to minimize it. For example, they posit that a purchaser early in the class period who later sells will desire to maximize the deflation due to an intervening corrective disclosure in order to maximize his out of pocket damages, but in so doing will conflict with his purchaser, who is interested in maximizing the inflation in the price he pays. We agree that class members might at some point during this litigation have differing interests. We altogether disagree, for a spate of reasons, that such potential conflicts afford a valid reason at this time for refusing to certify the class.

Defendants' position depends entirely on adoption of the out of pocket loss measure of damages, rather than a rescissory

quirement set out there that there be a reasonable transactional nexus between the fraud and the loss—we simply amplify on the manner in which that nexus may be proved.

23. Indeed, we could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation (*i.e.*, economic damage) regardless of transactional causation, without implicating the Enabling Act limitation.

measure. Under the out of pocket standard each purchaser recovers the difference between the inflated price paid and the value received, plus interest on the difference. If the stock is resold at an inflated price, the purchaser-seller's damages, limited by § 28(a) of the Act, 15 U. S. C. § 78bb(a) to "actual damages," must be diminished by the inflation he recovers from his purchaser. Thus, he is interested in proving that some intervening event, such as a corrective release, had diminished the inflation persisting in the stock price when he sold.[24]

While out of pocket loss is the ordinary standard in a 10b-5 suit. *Foster* v. *Financial Technology, Inc.*, ... F. 2d ....., No. 73-3203 (9th Cir., April 30, 1975), slip opinion at 3; *Janigan* v. *Taylor*, 344 F. 2d 781, 786 (1st Cir. 1965); *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962); *Abrahamson* v. *Fleschner*, 392 F. Supp. 740, at 746 (S. D. N. Y. 1975); *see Sigafus* v. *Porter*, 179 U. S. 116, 123 (1900); *Smith* v. *Bolles*, 132 U. S. 125 (1889); Note, *The Measure of Damages in*

24. Appellants contend that the inflation paid must be measured by the change in price after a corrective release. That drop is of course circumstantial evidence of the inflation when purchased, but it is not the exclusive method of measuring inflation. The fact finder may rely on other methods of determining actual value on the date of purchase, including expert testimony on actual value derived from capitalization of earnings techniques or testimony on book value. Particularly where, as here, the amount of inflation due to absence or insufficiency of reserves may fluctuate, such evidence is necessary in the absence of corrective releases. In any event, the drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period. Stanford Note, *infra*, at 384-385; *Tucker* v. *Arthur Andersen & Co., supra*, at 97,935. However, from an appropriate mix of the various methods we are confident that the jury will be able to trace a graph delineating the actual value of the stock throughout the class period. When compared with a comparable graph of the price the stock sold at, the determination of damage will be a mechanical task for each class member.

Rule 10b-5 Cases Involving Actively Traded Securities, 26 Stan. L. Rev. 371, 383-384 (1974); 3 A. Bromberg, Securities Law, Fraud—Rule 10b-5, § 9.1, at 226-227 (1974), it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure. *Chasins* v. *Smith, Barney & Co.*, 438 F. 2d 1167, 1173 (2d Cir. 1970); *Abrahamson* v. *Fleschner, supra*, at 746; *see* Stanford Note, *supra*, at 374-376; A. Bromberg, *supra*, at 226, or to allow consequential damages. *Foster, supra*, at 3; *Zeller* v. *Bogue Elec. Mfg. Co.*, 476 F. 2d 795, 802-803 (2d Cir. 1973). It is for the district judge, after becoming aware of the nature of the case, to determine the appropriate measure of damages in the first instance; the possible creation of potential conflicts by that decision does not render the class inappropriate now. The Rule provides the mechanism of subsequent creation of subclasses, Rule 23(c)(4), to deal with latent conflicts which may surface as the suit progresses. *Green* v. *Wolf Corporation, supra*, at 299; *Tucker* v. *Arthur Andersen & Co., supra*, at 97,936-97,937; *Handwerger* v. *Ginsberg*, CCH Fed. Sec. L. Rep. ¶ 94,934, at 97,241 (S. D. N. Y. 1975); *Caesars Palace Securities Litigation, supra*, at 398; *Sol S. Turnoff* v. *N. V. Nederlandsche Combinatie Voor Chemische Industrie*, 51 F. R. D. 227, 233 (E. D. Pa. 1970). As a result, courts have generally declined to consider conflicts, particularly as they regard damages, sufficient to defeat class action status at the outset unless the conflict is apparent, imminent, and on an issue at the very heart of the suit. *See Hawk Industries, Inc.* v. *Bausch & Lomb, Inc.*, 59 F. R. D. 619 (S. D. N. Y. 1973); *Siegel* v. *Realty Equities Corporation of New York, supra*, at 426.

Here, the conflict, if any, is peripheral, and substantially outweighed by the class members' common interests. Even assuming *arguendo* that the out of pocket standard applies, the class is proper. Every class member shares an overriding common interest in establishing the existence and materiality of misrepresentations. The major portion of the inflation alleged is attributed

to causes which allegedly persisted throughout the class period. It will be in the interest of each class member to maximize the inflation from those causes at every point in the class period, both to demonstrate the *sine qua non*—liability—and to maximize his own potential damages—the more the stock is inflated, the more every class member stands to recover. Moreover, because the major portion of the inflation is attributed to causes persisting throughout the period, interim corrective disclosures (of which there appear to have been only two or three) do not necessarily bring predisclosure purchasers into conflict with post-disclosure purchasers. Because both share an interest in maximizing overall inflation, the latter purchaser will no doubt strive to show a substantial market effect from disclosure of the lesser (or partial) causes of inflation to maximize the inflation attributable to more serious causes persisting when he bought—a showing which will increase the recovery of the earlier purchaser. In that light, any conflicting interests in tracing fluctuations in inflation during the class period are secondary, and do not bar class litigation to advance predominantly common interests. Courts faced with the same situation have repeatedly, either explicitly or implicitly, rejected defendants' position, for the potential conflict is present in most prolonged classes involving a series of misrepresentations. *See Green* v. *Wolf Corporation, supra; Tucker* v. *Arthur Andersen & Co.*, at 97,931-97,932 and 97,932 n. 14, and cases there cited, and at 97,936; *Aboudi* v. *Daroff, supra*, at 391-392; *U. S. Financial Securities Litigation, supra*, at 452; *In re Memorex Security Cases, supra; Caesars Palace Equities Litigation, supra; Siegel* v. *Realty Equities Corporation of New York, supra*, at 426; *Dolgow* v. *Anderson, supra; Fischer* v. *Kletz, supra*, at 381-383; *Kronenberg, supra.*

In support of that conclusion, we note that Rule 23 makes no mention of conflicts. The Rule's requirements are that the representative's claims be "typical" and that the class be "fairly and adequately" represented—claims need not be coextensive. *Caesars Palace Securities Litigation, supra*, at 397. Those re-

quirements are in part constitutionally dictated, as due process requires, in order to give collateral res judicata effect to a judgment against class members, that their interests have been adequately represented in the class action. *Hansberry* v. *Lee*, 311 U. S. 32 (1940).

Hansberry does not, however, as defendants seem to assume, dictate that any divergence of interest among class members violates due process (thereby necessarily requiring an identity of interests to satisfy Rule 23's adequacy or representation and typicality requirements). Neither the Rule's requirements nor those of due process are so inflexible. The due process touchstone of adequacy and fairness of representation (*see In re Four Seasons Securities Laws Litigation;* 502 F. 2d 834, 842 (10th Cir. 1974); *Eisen IV*, at 177) must be judged in light of the seriousness and extent of conflicts involved compared to the importance of issues uniting the class; the alternatives to class representation available;[25] the procedures available to limit and prevent unfairness; and any other facts bearing on the fairness with which the absent class member is represented.

Hansberry is not controlling here—in *Hansberry* there was nothing to satisfy due process. Not only were the members of the purported class of property owners diametrically opposed on the central issue—the validity of racial covenants restricting their property—but the state class action procedure provided absent class members no notice. Here, on the other hand, under

25. The rule requires adequate representation. The alternative may be none at all.

> "The basic concept of commonality, a requirement which is prevalent throughout Rule 23 and is premised upon a fundamental recognition that representatives of a class must have interests which are not in opposition to the members of that class, must be interpreted to best effectuate the primary purposes of the class action device, i.e., to give small investors a reasonable opportunity to vindicate their claims in a manner which will not place an undue burden upon them. It is in this light that we must approach the defendants' objections to the instant class actions under Rule 23(a)(3)." *Caesars Palace Securities Litigation, supra,* at 397-398.

the notice and opt-out procedure of Rule 23(b)(3) and 23(c)(2), an absent class member may evaluate his position in the class and decide for himself whether to avail himself of the representation offered. *See, e.g., Four Seasons Securities Laws Litigation, supra,* at 842-844; *Herbst* v. *Able, supra,* at 15. The potential conflicts are at most peripheral. And the district judge will retain constant supervision, through his powers under Rule 23(d) and (e), and through his ability to decertify or create sub-classes, to assure fairness of representation. *See Dolgow* v. *Anderson, supra,* at 496. Finally, and unlike numerous cases in which even one representative has been held adequate to represent a prolonged class, the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus will probably represent whatever conflicting interests there are in the development of plaintiffs' trial strategies. In light of those various factors, we agree with the district judge that the class representatives are typical and will adequately and fairly represent the class.[26]

AFFIRMED.

---

26. We likewise reject the contention that conflicts between debenture holders and shareholders require decertification at this time; *see Handswerger* v. *Ginsberg, supra,* at 97,240-97,241; *Caesars Palace Securities Litigation, supra,* at 398-399; *Fischer* v. *Kletz, supra,* at 384; or that present shareholders and those purchasers who have sold their shares irreconcilably conflict. *See Handswerger, supra,* at 97,240 n. 3; *Herbst* v. *ITT, supra,* at 1314; *Herbst* v. *Able, supra,* at 15.